

HIDDEN LIENS REPORT

**a project of the UCC Committee of the
Business Law Section of the State Bar of California**

TABLE OF CONTENTS

Note: As noted in the Introduction to this report, the Table of Contents reflects those liens selected by the UCC Committee from the extensive list of liens appearing at the end of this report. The liens appearing in bold are included in this first draft of the Hidden Liens Report.

A.	LIENS ARISING IN SALES TRANSACTIONS	2
1.	Interest of buyer in identified goods under Commercial Code Section 2501.....	2
2.	Security interest reserved by seller pursuant to Commercial Code Section 2505.	2
3.	Reclamation right of seller under Commercial Code Section 2702	4
4.	Security interest of buyer in rejected goods pursuant to Commercial Code 2711.	7
5.	Lien of seller of real property under Civil Code Section 3046.	9
6.	Lien of purchaser of real property under Civil Code Section 3050.	11
B.	LIENS FOR PERFORMANCE OF SERVICES	13
1.	Bankers' Liens	13
a.	Banker's lien under Civil Code Section 3054.	13
b.	Banker's lien under Financial Code Section 1670.	15
2.	Liens for Warehousing and Storage	16
a.	Warehouseman's Lien (Commercial Code Section 7209)	16
b.	Garageman's Lien under Civil Code Section 3068	20
3.	Carriers' Liens.....	22
a.	Carrier's lien under Commercial Code Section 7307.....	22
b.	Carrier's liens for freightage under Civil Code Section 2144.....	22
4.	Other Liens for Services.....	22
a.	Liens Arising under Civil Code § 3051 and § 3051.5.....	22
b.	Jeweler's Lien.....	22
c.	Lien of Mining Claimant under Civil Code 3060.....	22
d.	Logger's and Lumber-Millman's Liens.....	22
e.	Factor's lien under Civil Code Section 3053.....	23
f.	Lien for Aircraft Repairs (Business & Professions Code §9798.1).....	23
g.	State Lien In Connection With The Operation Of Airport Or Air Navigation Facility By State (Arising Under Public Utilities Code § 21640).....	23
h.	Customs broker's lien (Arising Under 19 U.S.C. § 1564 (2005), As Amended).....	23
C.	LIENS ARISING IN LITIGATION	23
1.	Attachment of inventory by taking possession through a "keeper" under Code of Civil Procedure Section 488.395.....	23
2.	Judgment and Execution Orders (Arising Under California Code Of Civil Procedure §§708.110, 708.120 and 708.205)	23
3.	Liens arising in creditor's suit under Code of Civil Procedure Section 708.250.	27
4.	Liens arising under charging order under Code of Civil Procedure Section 708.320 and Corporations Code Sections 16504 and 17302.	29
5.	Liens for money owed to judgment debtor by public entity under Civil Procedure Section 708.780.	33
D.	AGRICULTURAL LIENS	35
1.	Trust under Perishable Agricultural Commodities Act, 7 U.S.C. §§499 <i>et seq.</i>	35
2.	Trust under Packers and Stockyards Act, 7 U.S.C. §§181 <i>et seq.</i>	36
3.	Agricultural laborer's lien under Civil Code Section 3061.5.....	36
E.	TAX AND OTHER GOVERNMENTAL LIENS	36

A TABLE OF CONTENTS
(continued)

		Page
1.	Federal tax liens arising under the Internal Revenue Code against “all property and rights to property, whether real or personal” that belong to the taxpayer, 26 U.S.C. §6321.	36
2.	Unpaid sales and use taxes under Rev. & Tax. Code Section 6757.	44
3.	Environmental contamination giving rise to liens under the Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. §§9601 <i>et seq.</i> (CERCLA).	44
4.	ERISA liens under 29 U.S.C. §1368.	44
5.	Lien for public employees' retirement systems under Government Code Section 20574.	44
6.	Liens for unpaid wages pursuant to the "hot goods" section of the federal Fair Labor Standards Act, 29 U.S.C. §215(a)(1).	45
7.	Liens for utility and related services	49
a.	Lien for special assessment the weed and rubbish abatement under Government Code Section 39577.	49
b.	Lien for abatement of nuisances under Government Code Section 38773.	49
c.	Lien for furnishing utility services under Pub. Res. Code Section 5003.7.	49
d.	Special assessments for street and highway improvements under Sts. & Hwy. Code Section 3115.	50

HIDDEN LIENS REPORT

Introduction

Attorneys and non-attorneys alike are quite familiar with liens. The most frequently encountered liens arise from a limited category of circumstances such as liens against real or personal property to secure loans, wage garnishments, liens imposed for failure to pay taxes and mechanics' liens. However, liens may be imposed in a variety of circumstances, and in California the power to create liens is found in several different chapters of the California statutory codes. Not surprisingly, the process to create liens varies and determining the relative priority of these liens can be complicated.

Many practitioners are aware of the types of liens created under Division 8 or 9 of the California Commercial Code, real property liens, judgment liens, and liens created under federal statutory schemes (*e.g.*, aircraft, copyrights). Notice of the existence of many of these types of liens can be obtained from a search of public recording systems, such as the Secretary of State's Office, real property records, or the U.S. Copyright Office. There are, however, another group of liens that are not evidenced in a public record, which makes uncovering them especially difficult for debtors and secured parties alike. These so-called "hidden liens" are the subject of this report.

We are not aware of any generally available comprehensive compilation of the types of hidden liens that exist under California and federal law. This information void has a mystical quality to it as many practitioners do not even attempt to become familiar with the different types of liens that exist in part because of the mere expanse of the subject and the perceived unlikelihood of encountering a hidden lien that is material. It is often the case, therefore, that secured parties and their attorneys are surprised to learn of a "hidden lien" that interferes with the priority of a security interest arising under Division 8 or 9 of the California Commercial Code. This report is the culmination of a multi-year effort by the UCC Committee of the Business Law Section of the State Bar of California (the "UCC Committee") to demystify "hidden liens" by identifying, indexing and describing liens that can be created under federal or California statutes other than pursuant to a typical secured loan transaction.¹

At the end of this report is an extensive list of liens that the UCC Committee has assembled by reviewing federal and California statutes. These liens fall into six broad categories: (1) liens arising in sales transactions, (2) liens for performance of services, (3) liens arising in litigation, (4) agricultural liens, (5) tax and other governmental liens, and (6) liens on particular types of personal property. The liens appearing in bold face on the list are identified in the Table of Contents and will be discussed in detail in the balance of the report.² The UCC Committee identified the liens that are most likely to be encountered by secured parties for discussion in this report. Also, the UCC Committee selected some of the other liens that were exemplary of a particular category of liens for further discussion. The discussion that follows for each lien identified includes the manner in which the lien arises, attaches and is perfected, how

¹ Therefore, this report does not discuss liens arising under Revised Articles 8 or 9 of the Commercial Code which has been the subject of extensive discussion and commentary.

² Future versions of the report will contain discussions of those identified liens not analyzed in this current draft.

priority is determined, recommendations for identifying and protecting the secured party against the lien, the types of obligations that can be secured by the lien, and the types of collateral and classes of persons that are subject to the lien.

A few words of caution are appropriate. The hidden liens were created under many different types of laws, by different legislative bodies (the U.S. Congress and California legislature) and at different times. Therefore, there certainly are intricacies and nuances that will be grasped only by experienced practitioners in the specific area, and by writing this report, we do not profess to be such practitioners. Our approach has been to provide an introduction to the hidden lien based upon what could be discerned directly from a plain statutory reading and, in some situations, any leading cases in the area. In addition, a byproduct of the sheer breadth of this report is that the lien analyses were prepared at different times. Although we have performed considerable review and updating, the analysis in a particular area may not necessarily provide the most current information as of the date of this report. While we believe this report can serve as an initial starting point for perspective and where to look for more information, it should not be considered a definitive authority on these subjects.

Finally, the UCC Committee gratefully acknowledges the Insolvency Committee of the Business Law Section of the State Bar of California and the Agribusiness Committee of the Business Law Section of the State Bar of California for their contribution to the completion of the report.

DISCUSSION OF SELECTED HIDDEN LIENS

A. LIENS ARISING IN SALES TRANSACTIONS

1. Interest of buyer in identified goods under Commercial Code Section 2501.

[TO BE ADDED IN SUBSEQUENT DRAFT]

2. Security interest reserved by seller pursuant to Commercial Code Section 2505.

Statutory Framework:

Commercial Code § 2505 provides as follows:

(1) Where the seller has identified goods to the contract by or before shipment:

(a) His procurement of a negotiable bill of lading to his own order or otherwise reserves in him a security interest in the goods. His procurement of the bill to the order of a financing agency or of the buyer indicates in addition only the seller's expectation of transferring that interest to the person named.

(b) A nonnegotiable bill of lading to himself or his nominee reserves

possession of the goods as security but except in a case of conditional delivery (subdivision (2) of Section 2507) a nonnegotiable bill of lading naming the buyer as consignee reserves no security interest even though the seller retains possession of the bill of lading.

(2) When shipment by the seller with reservation of a security interest is in violation of the contract for sale it constitutes an improper contract for transportation within the preceding section but impairs neither the rights given to the buyer by shipment and identification of the goods to the contract nor the seller's powers as a holder of a negotiable document.

How the Lien Arises/Attaches:

The lien arises when a seller has identified goods to a contract and procured a bill of lading for shipment, except if a nonnegotiable bill of lading lists the buyer as a consignee. The lien lasts until the buyer has lawfully obtained possession of the goods.

Perfection of the Lien:

No further action is necessary to perfect the lien.

Priority of the Lien:

Commercial Code Section 9110 subjects a security interest arising under Section 2505 to Division 9, and provides that, until the recipient obtains possession of the goods, the security interest has priority over conflicting security interests, including a security interest existing prior to the creation of the Section 2505 lien.

The Obligations Secured by the Lien:

The security interest is restricted to securing payment or performance by the buyer and does not affect the location of title generally.

The Property Subject to the Lien:

This lien pertains to any identified goods under shipment. Section 2105 defines "goods" as

. . . all things (including specially manufactured goods) which are movable at the time of identification to the contract or sale other than the money in which the price is to be paid, investment securities . . . and things in action. "Goods" also includes the unborn young of animals and growing crops and other identified things attached to realty as described in the section on goods to be severed from realty

The Classes of Secured Party/Debtor Subject to the Lien:

Secured parties are any party taking a security interest in the assets of a debtor that are used to purchase shipped goods.

Debtors are buyers of goods who have not received the goods.

How a Secured Party Can Maintain its Priority or Protect its Security Interest Against the Hidden Lien, including Recommended Due Diligence:

Generally a secured party cannot maintain its priority over this hidden lien. However, the operation of this lien is not likely to place a secured party who has an all asset grant or where the security interest includes proceeds of such goods in a particularly bad position. Any payments made by the buyer to the seller for such goods will presumably become a component of the secured party's collateral. Because a large percentage of the lien amount will probably be allocable to payments made by the buyer, except in cases where the buyer incurred large amounts of expenses with respect to the goods, the payments made by the buyer should generally cover the damage to the secured party's position caused by the effective subordination of its security interest of the seller.

Secured parties can protect themselves against this hidden lien by requesting that shipment involve a nonnegotiable bill of lading naming the buyer/debtor as consignee.

3. **Reclamation right of seller under Commercial Code Section 2702**

Statutory Framework:

Commercial Code § 2702(2), (3) states as follows:

(2) Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within 10 days after receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the 10-day limitation does not apply. Except as provided in this subdivision the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.

(3) The seller's right to reclaim under subdivision (2) is subject to the rights of a buyer in the ordinary course or other good faith purchaser under this division (Section 2403). Successful reclamation of goods excludes all other remedies with respect to them.

Inasmuch as the right to reclaim goods under § 2702(2) vests a seller with the right to specific goods on account of the buyer/debtor's obligations, i.e. the payment of the purchase price or damages for breach, the reclamation right operates like a lien on the goods.

How the Lien Arises/Attaches:

The reclamation right, which is effectively a lien, arises when a seller of goods sells goods on credit to an insolvent buyer. The right expires if no demand for return is made within 10 days of the buyer's receipt of the goods where buyer makes no misrepresentation with respect to insolvency, but the 10 day time limit does not apply if the buyer makes a written misrepresentation as to its solvency within 3 months of delivery of the goods. As discussed below, if the buyer files a bankruptcy petition before the 10 days period expires, Bankruptcy Code Section 546 (c) will under certain circumstances extend the time to make a timely demand for return of the goods.

Perfection of the Lien:

A seller must demand the return of the goods by the buyer within 10 days of the buyer's receipt of the goods. No other filings or notices valid are required to create an enforceable reclamation right.

Priority of the Lien:

§ 2702(3) expressly states that a seller's reclamation right is subject to the rights buyers in the ordinary course or other good faith purchasers. Most secured creditors of a buyer will constitute "good faith purchasers" under the Commercial Code (Sections 1201(20), (29) and (30)), so the right of a seller to reclaim goods will typically be subordinate to the rights of a secured creditor of the buyer. See, e.g. *In re Nitram, Inc.*, 323 B.R. 792, 797 (Bankr. M.D. Fla 2005). Lien creditors of the buyer are subject to a seller's reclamation rights.

The Obligations Secured by the Lien:

As the reclamation right is not truly a lien it secures nothing but the right to have the goods themselves returned. If exercised, the reclamation right is an exclusive remedy.

The Property Subject to the Lien:

Any goods which are sold to the buyer when the buyer is insolvent and which are actually received by the buyer. Section 2105 defines "goods" as:

. . . all things (including specially manufactured goods) which are movable at the time of identification to the contract or sale other than the money in which the price is to be paid, investment securities . . . and things in action. "Goods" also includes the unborn young of animals and growing crops and other identified things attached to realty as described in the section on goods to be severed from realty.

The right to reclaim goods only applies to goods that the buyer retains: the "lien" does not follow the goods into proceeds or other goods into which the goods may be incorporated.

The Classes of Secured Party/Debtor Subject to the Lien:

A buyer/debtor who buys goods while insolvent is subject to the reclamation right.

A secured creditor who takes as collateral anything constituting “goods” as such term is defined in Commercial Code § 2105 may have to contend with a seller’s right of reclamation rights. As noted above, such secured creditors’ lien, if valid and perfected, would not be subject to such reclamation right.

How a Secured Party Can Maintain Its Priority or Protect its Security Interest Against the Hidden Lien, Including Recommended Due Diligence:

Generally, a secured party’s priority will not be at risk when a seller asserts its reclamation rights because as a “good faith purchaser” those rights will not be subject to a seller’s reclamation right.

Miscellaneous:

Prior to the 2005 amendments to the U.S. Bankruptcy Code, Section 546(c) preserves seller’s state law reclamation rights, with a few minor alterations. The recent amendments to the Bankruptcy Code completely rewrote § 546(c), which now reads as follows:

(1) Except as provided in subsection (d) of this section and in section 507(c), and subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof, the rights and powers of the trustee under sections 544(a), 545, 547, and 549 are subject to the right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller’s business, to reclaim such goods if the debtor has received such goods while insolvent, within 45 days before the date of the commencement of a case under this title, but such seller may not reclaim such goods unless such seller demands in writing reclamation of such goods –

(A) not later than 45 days after the receipt of such goods by the debtor; or (B) not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case.

(2) If a seller of goods fails to provide notice in the manner described in paragraph (1), the seller still may assert the rights contained in section 503(b)(9) [giving administrative priority to sellers of goods sold to the debtor in the ordinary course of business in the 20 days prior to the commencement of the bankruptcy].

This revision was not accompanied by any significant legislative history, so it is unclear exactly how sweeping these changes were intended to be. Some commentators have speculated that there now exists a federal reclamation right, and that state reclamation rights, such as Commercial Code § 2702, no longer

inform the exercise of reclamation rights when a buyer of goods is in bankruptcy. Sellers of goods, secured creditors who lend to buyers of goods, and their counsel are advised to track § 546(c) jurisprudence as it develops, which development may materially affect their rights in goods purchased by an insolvent buyer.

The subordination of the reclaiming seller's rights to the "prior rights of a holder of a security interest" (see § 546(c)(1)) does not employ the traditional language of priority used in the Commercial Code, and, while it appears to protect secured creditors to the same extent as Commercial Code § 2702, courts may interpret it as a less thorough protection than that given by § 2702.

4. **Security interest of buyer in rejected goods pursuant to Commercial Code 2711.**

Statutory Framework:

Commercial Code § 2711(3) states as follows:

On rightful rejection or justifiable revocation of acceptance a buyer has a security interest in goods in his possession or control for any payments made on their price and any expenses reasonably incurred in their inspection, receipt, transportation, care and custody and may hold such goods and resell them in like manner as an aggrieved seller . . .

The comments to this code section provide the following interpretive aid:

. . . [T]he buyer may hold and resell rejected goods if he has paid a part of the price or incurred expenses of the type specified. "Paid" as used here includes acceptance of a draft or other time negotiable instrument or the signing of a negotiable note. [The buyer's] freedom of resale is coextensive with that of a seller under [Article 2 of the Commercial Code] except that the buyer may not keep any profit resulting from the resale and is limited to retaining only the amount of the price paid and the costs involved in the inspection and handling of the goods. The buyer's security interest in the goods is intended to be limited to the items listed in subsection (3), and the buyer is not permitted to retain such funds as he might believe adequate for his damages. The buyer's right to cover, or to have damages for non-delivery, is not impaired by his exercise of his right of resale.

How the Lien Arises/Attaches:

The lien arises when a buyer has rightfully rejected goods or justifiably revoked acceptance of goods, possesses or controls such goods and has either paid for such goods in whole or in part, accepted a draft or other negotiable instrument, signed a negotiable note or incurred reasonable expenses related to such goods.

Perfection of the Lien:

The buyer must possess or control the goods for the lien to attach. No further action is necessary to perfect the lien.

Priority of the Lien:

Commercial Code § 9110 subjects a security interest arising under §2711(3) to Division 9, and provides that, until the seller/debtor again obtains possession of the goods, the security interest has priority over a conflicting security interest created by the seller/debtor, including a security interest existing prior to the creation of the §2711(3) lien.

The Obligations Secured by the Lien:

The lien secures a seller's obligation to repay a buyer for the buyer's payments for, or reasonable expenditures with regard to goods with respect to which the buyer rightfully rejects or justifiably revokes its acceptance.

The Property Subject to the Lien:

Any goods which are subject to Division 2 of the Commercial Code may become subject to the lien. Section 2105 defines "goods" as

. . . all things (including specially manufactured goods) which are movable at the time of identification to the contract or sale other than the money in which the price is to be paid, investment securities . . . and things in action. "Goods" also includes the unborn young of animals and growing crops and other identified things attached to realty as described in the section on goods to be severed from realty

The Classes of Secured Party/Debtor Subject to the Lien:

Secured creditors who take as collateral anything which might become "goods" as such term is defined in Commercial Code § 2105 are subject to the lien.

A seller of goods is subject to this lien.

How a Secured Party Can Maintain its Priority or Protect its Security Interest Against the Hidden Lien, including Recommended Due Diligence:

Generally, a secured party can't maintain its priority over this hidden lien. However, the operation of this lien should not place a secured party who has an all asset grant or where the security interest includes proceeds of such goods in a particularly bad position. Any payments made by the buyer to the seller for such goods will presumably become a component of the secured party's collateral. Because a large percentage of the lien amount will probably be allocable to payments made by the buyer, except in cases where the buyer incurred large amounts of expenses with respect to the goods, the payments made by the buyer

should generally cover the damage to the secured party's position caused by the effective subordination of its security interest to that of the buyer.

A secured party lending to a seller of goods might require the seller to include in all of its sales contracts a buyer waiver whereby the buyer agrees to immediately return goods that are rightfully rejected or the acceptance of which is justifiably revoked and to waive its security interest in such goods. This is an onerous provision for buyers, and it is unlikely that a seller, afraid of the aversion buyers might have to such a provision, would agree to include such a provision in all of its sales contracts.

A secured party could require its debtor (the seller) to give prompt notice of any rejection or revocation of acceptance. This would enable the secured party to monitor the creation of §2711(3) liens. Sellers of goods will sometimes have cure rights under Division 2, and, if the problem that led to the buyer rightfully refusing goods or justifiably revoking its acceptance of goods is cured, then the lien will cease to exist. A secured party with notice of a rejection or revocation may be in a position to exert influence on its debtor to cause it to effectuate such a cure.

Secured parties who lend to sellers who scrupulously honor their sales contracts will have the most success in avoiding § 2711(3) liens.

5. **Lien of seller of real property under Civil Code Section 3046.**

Statutory Framework:

Civil Code §3046 provides as follows:

Lien of Seller of Real Property. One who sells real property has a vendor's lien thereon, independent of possession, for so much of the price as remains unpaid and unsecured otherwise than by the personal obligation of the buyer.

How the Lien Arises/Attaches:

The vendor's lien under California Civil Code §3046 arises in transactions for the sale of real property where the purchaser does not furnish full consideration. An explicit contractual provision is not necessary, as the vendor's lien arises by operation of law. *Cain v. Hunter*, 161 Cal. App. 2d 808, 812 (Cal. App. 1 Dist. 1958). No recording or other further action is necessary in order for the lien to be valid. The vendor's lien arises and is operational upon transfer of title when the purchaser becomes a debtor for an ascertained fixed consideration of money that is not otherwise secured. *McGreevy v. Constitution Life Ins. Co.*, 238 Cal. App. 2d 364, 368 (App. 5 Dist. 1965).

Priority of the Lien:

Civil Code §3048 provides as follows:

The liens defined in sections 3046 and 3050 are valid against every one claiming under the debtor, except a purchaser or incumbrancer in good faith and for value.

If a purchaser sells the real property or grants a deed of trust to a third party for value and without notice of an existing vendor's lien, the third party has priority. A deed of trust given to secure a pre-existing debt grants the secured party, who had no notice of the vendor's lien, the status of a bona fide purchaser for valuable consideration and priority over a vendor's lien. *Valley Vista Land Co. v. Nipomo Water & Sewer Co.*, 266 Cal. App. 2d 331, 340 (App. 2 Dist. 1968); *Schut v. Doyle*, 168 Cal. App. 2d 698, 701-702 (App. 4 Dist. 1959).

Further, regardless of whether it has notice of a vendor's lien, a secured party has priority when a purchase-money mortgage or deed of trust in favor of the secured party and a vendor's lien in favor of the seller arise out of a single sale transaction. *Brock v. First South Savings Assn.*, 8 Cal. App. 4th 661, 665 (App. 3 Dist. 1992). Thus, if a secured party extends credit to a purchaser for the acquisition of real property and the purchaser does not pay full consideration, the deed of trust in favor of the secured party takes priority over a vendor's lien. *Id.*

On the other hand, the vendor's lien takes precedence over claims and liens of judgment and attachment creditors of the debtor. *Schut v. Doyle*, 168 Cal. App. 2d 698, 703 (App. 4 Dist. 1959).

The Obligations Secured by the Lien:

The vendor's lien secures any amount of the purchase price of real property that remains unpaid by the purchaser and is otherwise unsecured.

The Collateral Subject to the Lien:

The interest in real property for which full consideration was not paid by the purchaser, even if such interest is less than a fee interest, is the only property of the purchaser that is subject to the vendor's lien. *Rogers Development Co. v. Southern California Real Estate Inv. Co.*, 159 Cal. 735, 740 (Cal. 1911).

The Classes of Secured Party/Debtor Subject to the Lien:

- a) The purchaser of the real property.
- b) Secured parties or creditors taking a lien in the real property in transactions subsequent to its purchase, except for any party who is a bona fide purchaser or encumbrancer for value and without notice of the Vendor's Lien.

How a Secured Party Can Maintain Its Priority or Protect its Lien Against the Hidden Lien, Including Recommended Due Diligence:

When lending money for the purchase of real property, a secured party is not adversely affected by the Vendor's Lien as the secured party's security interest is superior to any Vendor's Lien that may arise from the transaction.

When lending money to a real property owner, a secured party is a bona fide encumbrancer for value and is not affected by a vendor's lien so long as it has no notice of the lien. If a secured party has any reason to believe that a vendor's lien might exist on real property collateral, it may be prudent to undertake one or more of the following due diligence actions: (i) obtain copies of the purchase agreement and escrow agreement pursuant to which the real property owner acquired the property; (ii) obtain evidence that full consideration has been paid by the real property owner to the seller or that any deficiency in consideration is otherwise secured; and/or (iii) obtain a vendor's lien waiver executed by the seller.

Miscellaneous:

The vendor's lien can be waived by the seller without following any particular formality, however, the burden of showing waiver is on the asserting party. *McGreevy v. Constitution Life Ins. Co.*, 238 Cal. App. 2d 364, 368 (App. 5. Dist 1965). Any action which shows intent to waive the vendor's lien is sufficient to do so, including taking independent security for unpaid consideration or entering into an agreement pursuant to which the seller waives the lien.

6. Lien of purchaser of real property under Civil Code Section 3050.

Statutory Framework:

Civil Code §3050 provides as follows:

Purchaser's Lien On Real Property. One who pays to the owner any part of the price of real property, under an agreement for the sale thereof, has a special lien upon the property, independent of possession, for such part of the amount paid as he may be entitled to recover back, in case of a failure of consideration.

How the Lien Arises/Attaches:

The Vendee's lien in the amount paid to the seller arises in favor of a real property purchaser when such purchaser has entered into a contract and paid money towards the purchase price of real property and the seller fails to meet its obligations under the contract. *Benson v. Shotwell*, 87 Cal. 49, 54-55 (1890). No recording or other further action is necessary in order to perfect the lien.

Moreover, when a seller refuses to convey per the terms of a contract, the purchaser can elect to treat the contract as terminated and foreclose on the Vendee's Lien for any money paid towards the purchase price of the real property. *Moresco v. Foppiano*, 7 Cal. 2d 242, 247 (1936).

However, the Vendee's lien arises only when the purchaser was not first in breach of the contract. *Benson v. Shotwell*, 87 Cal. 49, 54-55 (1890); *Wilson v. Smith*, 69 Cal. App. 211, 214 (App. 2 Dist. 1924).

Priority of the Lien:

Civil Code §3048 provides as follows:

The liens defined in sections 3046 and 3050 are valid against everyone claiming under the debtor, except a purchaser or encumbrancer in good faith and for value.

A subsequent purchaser or encumbrancer for value and without notice is not subject to the vendee's lien. In contrast, a deed of trust granted subsequent to the date of the purchase contract does not have priority over a vendee's lien when the secured party has notice of the lien. *Lockie v. Cooperative Land Co.*, 207 Cal. 624, 628-29 (1929). Additionally, even if a secured party holds a deed of trust prior to the date of a purchase contract, optional additional advances secured by the deed of trust but made after the date of the purchase contract are inferior to the vendee's lien if the secured party was on notice of the purchase contract. *Garcia v. Atmajian*, 113 Cal. App. 3d 516, 519-21 (App. 5 Dist. 1980).

The Obligations Secured by the Lien:

The vendee's lien secures any amount paid towards the purchase price of the real property including money spent by the purchaser towards improvements, taxes and insurance. *Garcia v. Atmajian*, 113 Cal. App. 3d 516, 521 (App. 5 Dist. 1980); *Lockie v. Cooperative Land Co.*, 207 Cal. 624, 628 (1929).

The Collateral Subject to the Lien:

The real property for which purchase money is rendered is the only property of the seller subject to the vendee's lien. *Newcomb v. Title Guarantee & Trust Co.*, 131 Cal. App. 329, 333 (App. 1 Dist. 1933).

The Classes of Secured Party/Debtor Subject to the Lien:

- a) The seller of the real property.
- b) Secured parties or creditors taking a lien in the real property subsequent to the date of the purchase contract, except for any party who is a bona fide purchaser or encumbrancer for value and without notice of the Vendee's Lien.

How a Secured Party Can Maintain Its Priority or Protect its Lien Against the Hidden Lien, Including Recommended Due Diligence:

When lending money to a real property owner, a secured party is a bona fide encumbrancer for value and is not affected by a vendee's lien so long as it has no

notice of the lien. If a secured party has any reason to believe that a vendee's lien might exist on potential real property collateral, it may be prudent to undertake one or more of the following due diligence actions: (i) obtain copies of the purchase agreement and all related documents under which it believes a vendee's lien might arise; (ii) obtain evidence that any payments towards the purchase price have been repaid by the real property owner; and/or (iii) obtain a waiver executed by the holder of the suspected vendee's lien.

Similarly, if a secured party holds a deed of trust securing future obligations and obtains notice of a Vendee's Lien, it should strongly consider taking one of the above actions before making additional optional advances to the real property owner.

B. LIENS FOR PERFORMANCE OF SERVICES

1. Bankers' Liens.

a. Banker's lien under Civil Code Section 3054.

Statutory Framework:

Civil Code §3054, subdivision (a) provides as follows:

A banker, or savings and loan association, has a general lien, dependent upon possession, upon all property in his or her hands belonging to a customer, for the balance due the banker or savings and loan association from the customer in the course of the business.

How the Lien Arises/Attaches:

This lien is applicable to any deposit of the securities (such as commercial paper) deposited with a bank by the customer in the course of business. *Kruger v. Wells Fargo Bank* (1974) 11 Cal 3d 352, 521 P 2d 441; *Pendleton v. Hellman Commercial Trust & Sav. Bank* (1922) 58 Cal App 448, 208 P 702. This is distinguished from the bank's "lien" against a depositor's account or funds on deposit, which is technically a right of setoff. *Id.* However, subdivision (b) of Civil Code §3054 expressly limits the exercise of the banker's lien with respect to deposit accounts, thereby implicitly confirming that the banker's lien also applies to deposit accounts. The money or property subject to the lien may then be applied by the bank toward the extinguishment of any matured indebtedness owed to it. *American Surety Co. v. Bank of Italy* (1923) 63 CA 149, 218 P 466. The exercise of this lien with respect to deposit accounts is subject to the limitations and procedures set forth in Fin. Code §§ 864 and 6600. A bank may also obtain a security interest expressed by a written contract as collateral for the debt owing to the bank by the customer.

Perfection of the Lien:

The lien is perfected by possession and the bank or savings and loan association need not take any action to perfect its lien.

Priority of the Lien:

Priority vis-à-vis Article 9 Security Interests. Section 9109(d)(2) of the Commercial Code provides that Division 9 does not apply to a lien, other than an agricultural lien, given by statute or other rule of law for services or materials, but Section 9333 applies with respect to priority of the lien. Section 9333 of the Commercial Code specifically provides that “[a] possessory lien on goods has priority over a security interest in the goods unless the lien is created by a statute that expressly provides otherwise.” Civil Code Section 3054 does not provide otherwise.

Priority vis-à-vis Other Liens. Section 2897 of the Civil Code generally provides that “[o]ther things being equal, different liens upon the same property have priority according to the time of their creation.” Although security interests do constitute “liens” under the general definition contained in Section 2872 of the Civil Code, this priority scheme does not apply to security interests. Section 2914 of the Civil Code specifically provides that more of the provisions contained in Sections 2872 through 2914 of the Civil Code apply to a security interest governed by the Commercial Code. Instead, this priority scheme applies solely to liens created under statutes or rules of law other than the Commercial Code.

The Obligations Secured by the Lien:

Any matured indebtedness owed by customer to the bank. This includes unmatured indebtedness owed to a bank upon the bankruptcy of the debtor/depositor. *Barrios & Co. v Indemnity Ins. Co.* (1929) 101 CA 675, 282 P 386.

The Collateral Subject to the Lien:

All property of a customer in the possession of the bank in the course of business is subject to the lien created by §3054, however, special deposits, such as items held in trust or pledged for a specific purposed are not subject to this lien. Additionally, certain property exempted from attachment or execution under former CCP §690.175 (now CCP §704.120), such as disability benefits or unemployment compensation is exempt from this lien. *Kruger v. Wells Fargo Bank* (1974) 11 Cal 3d 352, 521 P 2d 441.

The Classes of Secured Party/Debtor Subject to the Lien:

- (a) Secured parties are any party taking a security interest in the assets of a debtor that are held at a bank.

(b) Debtors are customers (i.e. natural-born persons) of a bank and guarantors of the indebtedness who also have accounts or property held by the bank in the course of business.

How a Secured Party Can Maintain Its Priority or Protect its Lien Against the Hidden Lien, Including Recommended Due Diligence:

Secured parties can protect themselves against this hidden lien by (a) requesting a waiver of this lien from any bank where collateral is held and (b) having the account or property held for it by the bank as escrow holder, trustee, custodian or other special purpose, as the property under the lien must belong “to the customer” and come into the hands of the banker in the course of business. See *Goggin v Bank of America* (1950) 183 F 2d 322.

b. Banker’s lien under Financial Code Section 1670.

Statutory Framework:

Financial Code §1670, provides as follows:

Whenever a bank receives personal property for safekeeping or storage as a bailee and issues a receipt therefore, the bank may enforce its lien as a warehouseman in accordance with the provisions of the Commercial Code or at its option in the manner provided in Sections 1671 to 1673, inclusive, of this article.

How the Lien Arises/Attaches:

This lien arises only when the bank is acting a bailee, and does not arise when the assets at hand are general deposits (see *Cory v. Golden State Bank* (1979) 95 CA3d 360, 157 Cal Rptr 538). Under Sections 1671 to 1763 of the Financial Code, the lien secures amounts owing to the bank for the safekeeping or storage of such personal property. If the amount so charged by the bank remains unpaid for 6 months from the date it was due, the bank may send a notice to the person in whose name the receipt was issued, giving the amount then due and stating that unless such amount and any other accrued charges are not paid, the bank will sell such personal property at a time and place named therein, but at least 30 days after the date of such mailing. Notice of such sale shall be published once at least five days prior to the sale in a newspaper of general circulation published in the county in which the sale is to be held, and if no such newspaper is published in such county, then the notice shall be posted in three public places at least five days prior to the sale. The bank shall be entitled to deduct the reasonable expenses for notices, advertising and sale from the proceeds of such sale. Any item offered for sale by the bank but for which no purchaser is found shall be retained by the bank for at least one year.

Perfection of the Lien:

No action is necessary to perfect this lien.

Priority of the Lien:

The statute does not specify priority but banker's liens are commonly understood to have priority over all other claims to the same collateral.

The Obligations Secured by the Lien:

Under Sections 1671 to 1763 of the Financial Code, the lien secures amounts owing to the bank for the safekeeping or storage of such personal property.

The Collateral Subject to the Lien:

Any personal property received by a bank for storage or safekeeping.

The Classes of Secured Party/Debtor Subject to the Lien:

- (a) Any bank that accepts personal property for storage or safekeeping.
- (b) Any person who uses a bank as bailee for personal property.

How a Secured Party Can Maintain Its Priority or Protect its Lien Against the Hidden Lien, Including Recommended Due Diligence:

Secured parties can obtain priority over the lien created under Financial Code §1670 and protect themselves against this hidden lien by possession of the personal property in question.

2. Liens for Warehousing and Storage

a. Warehouseman's Lien (Commercial Code Section 7209)

Statutory Framework:

Section 7209 of the California Commercial Code provides as follows:

A warehouseman has a lien against the bailor on the goods deposited or on the proceeds thereof in his possession for charges for storage, processing incidental to storage, or transportation, including demurrage and terminal charges, insurance, labor, or charges present or future in relation to the goods, and for expenses necessary for preservation of the goods or reasonably incurred in their sale pursuant to law. If the person on whose account the goods are held is liable for like charges or expenses in relation to other goods whenever deposited, the warehouseman also has a lien against him for such charges and expenses whether or not the other goods have been delivered by the warehouseman. But against a person to whom a negotiable warehouse receipt is duly negotiated a warehouseman's lien is limited to charges specified on the receipt or if no charges are so specified then to a reasonable charge for storage of the goods covered by the receipt subsequent to the date of the receipt.

The warehouseman may also reserve a security interest against the bailor for charges other than those specified in subdivision (1), such as for money advanced and interest, but if a receipt is issued for the goods such a security interest is not valid as against third persons without notice unless the maximum amount thereof is conspicuously specified (Section 1201) on the receipt. Such a security interest is governed by the division on secured transactions (Division 9).

(a) A warehouseman's lien for charges and expenses under subdivision (1) or a security interest under subdivision (2) is also effective against any person who so entrusted the bailor with possession of the goods that a pledge of them by him to a good faith purchaser for value would have been valid but is not effective against a person as to whom the document confers no right in the goods covered by it under Section 7503.

(b) A warehouseman's lien on household goods for charges and expenses in relation to the goods under subdivision (1) is also effective against all persons if the depositor was the legal possessor of the goods at the time of deposit. "Household goods" means furniture, furnishings and personal effects used by the depositor in a dwelling.

A warehouseman loses his lien on any goods which he voluntarily delivers or which he unjustifiably refuses to deliver.

How the Lien Arises/Attaches:

There are several types of liens/security interests provided for in Commercial Code § 7200. Commercial Code § 7209(a) provides for a specific lien against the goods in the warehouseman's possession for the storage charges incurred in connection with such goods. Commercial Code § 7209(a) also provides for a general lien that secures all storage charges incurred by the bailor, without regard to whether the charges are related to the goods then in the warehouseman's possession. In addition to the liens provided for in Commercial Code § 7209(a), Commercial Code § 7209(b) also permits a warehouseman to retain a security interest. Such a security interest is governed by Article 9 of the Commercial Code and a warehouseman must comply with the provisions of Article 9 for the security interest to attach.

A lien under Commercial Code § 7209(a) arises automatically when goods are delivered to the warehouseman, provided that:

- (a) the recipient of the goods must be a "warehouseman" ("a person engaged in the business of storing goods for hire" Commercial Code § 7102(1)(h)); and
- (b) a warehouse receipt has been issued in respect of the goods.

Perfection of the Lien:

A warehouseman's lien under Commercial Code § 7209(a) is a possessory lien and the warehouseman need not take any action to perfect its lien. Similarly, because a warehouseman has possession of the goods, it need not take any further action to perfect any security interest it retains pursuant to Commercial Code § 7209(b).

Priority of the Lien:

Priority vis-à-vis Article 9 Security Interests. Section 9109(d)(2) of the Commercial Code provides that Division 9 does not apply to a lien, other than an agricultural lien, given by statute or other rule of law for services or materials, but Section 9333 applies with respect to priority of the lien. Section 9333 of the Commercial Code specifically provides that "[a] possessory lien on goods has priority over a security interest in the goods unless the lien is created by a statute that expressly provides otherwise." UCC Section 7209 does not provide otherwise.

Priority vis-à-vis Other Liens. Section 2897 of the Civil Code generally provides that "[o]ther things being equal, different liens upon the same property have priority according to the time of their creation." Although security interests do constitute "liens" under the general definition contained in Section 2872 of the Civil Code, this priority scheme does not apply to security interests. Section 2914 of the Civil Code specifically provides that none of the provisions contained in Sections 2872 through 2914 of the Civil Code apply to a security interest governed by the UCC. Instead, this priority scheme applies solely to liens created under statutes or rules of law other than the Commercial Code.

Pre-Existing Interests:

As to security interests or other rights in goods that are in existence at the time goods are delivered to the warehouseman, a warehouseman's lien or security interest is subject to the restrictions of Commercial Code § 7503 pursuant to which a document of title confers no rights in goods as against a person who before issuance had a legal interest or a perfected security interest in such goods and neither (a) delivered or entrusted the goods or a document of title covering them to the bailor with actual or apparent authority to store the goods, nor (b) acquiesced in the procurement by the bailor of the document of title. The warehouseman's lien and security interest, however, will have priority as against any person who so entrusted the bailor with the goods that a pledge of them by the bailor to a good faith purchaser for value would have been valid. Commercial Code § 7209(c).

Subsequently Arising Interests:

If the warehouse receipt issued in respect of the goods is a non-negotiable receipt, then the warehouseman's lien is as effective against any third party taking the warehouse receipt as it is to the bailor.

If the warehouse receipt is negotiable, then as against a third party to whom the receipt was duly negotiated, the lien is limited to charges specified on the receipt or, if no charges are specified, then to a reasonable charge for storage of the goods covered by the receipt subsequent to the date of the receipt.

Obligations Secured by the Lien:

A warehouseman's lien secures "charges for storage, processing incidental to storage or transportation, including demurrage and terminal charges, insurance, labor, or charges present or future in relation to the goods, and for expenses necessary for the preservation of the goods or reasonably incurred in their sale pursuant to law." Commercial Code § 7209(a).

The lien also secures obligations for similar charges owing to the warehouseman in relation to other goods even if those other goods are not then in the warehouseman's possession. Under the uniform version of Commercial Code § 7209(a), a warehouseman must make a notation on the receipt if it is claiming a lien for storage charges related to goods other than those covered by the receipt. California's version of Commercial Code § 7209(a) is non-uniform in that it does not require such a notation on the receipt.

Under Commercial Code § 7209(b), a warehouseman may also reserve a security interest against the bailor for charges other than the storage-related charges. Such a security interest is governed by Article 9 of the Commercial Code. Because the warehouseman has possession of the goods in which it has such a security interest, there may not be a financing statement of record. However, if a receipt is issued for the goods, a security under Commercial Code § 7209(b) is not valid as against third parties without notice unless the maximum amount is conspicuously specified on the receipt.

The Collateral Subject to the Lien:

The warehouseman's lien under Commercial Code § 7209(a) extends to goods that are in the possession of the warehouseman. A warehouseman loses its lien on any goods which it voluntarily delivers or which it unjustifiably refuses to delivery.

As a warehouseman's security interest under Commercial Code § 7209(b) is governed by Article 9 of the Commercial Code, the scope of the collateral will depend on the documentation between the bailor and the warehouseman.

The Classes of Secured Party/Debtor Subject to the Lien:

This warehouseman's lien directly affects secured parties who finance debtors that deliver possession of goods to a warehouseman and debtors that deliver possession of goods to a warehouseman.

How a Secured Party Can Maintain Its Priority or Protect Its Lien Against the

Hidden Lien, Including Recommended Due Diligence:

To mitigate the effects of warehouseman's liens, a lender may consider:

(1) obtaining lien subordination agreements with any warehousemen, (2) carving any goods that are in the possession of a warehouseman from any borrowing base determination, (3) implementing a reserve for unpaid storage charges based upon the historical amounts owed to warehousemen (4) requiring regular reporting of amounts owed to warehouseman and the identity of the warehousemen and (5) including covenants in the loan agreement relative to the creation of warehouseman's liens and security interests.

b. Garageman's Lien under Civil Code Section 3068

How the Lien is Created:

The lien under Section 3068 of the Civil Code¹ is created when a person performs any of the following services (collectively, "Covered Services") with respect to a Qualifying Vehicle: (a) makes repairs or performs labor upon, and furnishes supplies or materials for, the Qualifying Vehicle; (b) engages in the storage, repair or safekeeping of the Qualifying Vehicle; or (c) rents parking space for the Qualifying Vehicle. For purposes of this analysis, a "Qualifying Vehicle" is any vehicle of a type subject to registration under the Vehicle Code of the State of California other than a manufactured home, a mobile home or a commercial coach. Notwithstanding the general rule for the time when liens created by operation of law are deemed to arise set forth in Section 2882 of the Civil Code, Section 3068 of the Civil Code specifically provides that the lien created thereunder arises upon the first to occur of (i) the time when a written statement of charges for completed work or services is presented to the registered owner and (ii) 15 days after the work or services are completed.

Perfection of the Lien:

Once the lien has been created, no additional steps are required or permitted in order to perfect the lien. However, unless the lienor either applies for an authorization to conduct a lien sale or commences a court action within 30 days after the lien arises, the lien will be extinguished. Also, because the lien created by Section 3068 of the Civil Code is dependent upon possession, the lien will generally be extinguished if the lienor relinquishes possession of the Qualifying Vehicle.

Priority of the Lien:

Priority vis-à-vis Article 9 Security Interests. Section 9201 of the Commercial Code provides in part that a transaction subject to Division 9 of the Commercial Code is subject to the applicable provisions of Title 14 of Part 4 of Division 3 of the Civil Code. As noted above, these provisions include Section 3068 of the Civil Code. Section 9201 of the Commercial Code also provides that in the event of a conflict between Division 9 of the Commercial Code and one of the above

provisions, the latter will control. Nothing in Section 3068 of the Civil Code or in any of the general provisions applicable thereto permits a security interest created under the Commercial Code to obtain priority over a lien created under Section 3068 of the Civil Code. Moreover, Section 9333 of the Commercial Code specifically provides that “[a] possessory lien on goods has priority over a security interest in the goods unless the lien is created by a statute that expressly provides otherwise.” Section 3068 of the Civil Code does not provide otherwise. In either event, it appears that a lien created under Section 3068 of the Civil Code is always prior in right to a security interest in the same property created under the Commercial Code.

Priority vis-à-vis Other Liens. Section 2897 of the Civil Code generally provides that “[o]ther things being equal, different liens upon the same property have priority according to the time of their creation.” Although security interests do constitute “liens” under the general definition contained in Section 2872 of the Civil Code, this priority scheme does not apply to security interests: Section 2914 of the Civil Code specifically provides that none of the provisions contained in Sections 2872 through 2914 of the Civil Code apply to a security interest governed by the Commercial Code. Instead, this priority scheme applies solely to liens created under statutes or rules of law other than the Commercial Code.

The Obligations Secured by the Lien:

The lien established by Section 3068 of the Civil Code secures payment of the compensation to which the person performing any Covered Services on the Qualifying Vehicle is legally entitled. However, certain limitations may apply to the overall amount of such compensation.

The Property Subject to the Lien:

The property subject to the lien is the Qualifying Vehicle.

The Classes of Lienor and Liennee Subject to the Lien:

Lienor. The lienor is the person who performs Covered Services on the Qualifying Vehicle.

Liennee. The lienees are the registered and legal owners of the Qualifying Vehicle on which Covered Services were performed.

How a Secured Party Can Maintain Its Priority or Protect its Security Interest Against the Lien, Including Recommended Due Diligence:

Protection Against Prior Liens. Because the lien created by Section 3068 of the Civil Code is dependent upon possession by the lienor, the best way for a secured party to protect against the lien is to obtain possession of any Qualifying Vehicle in which it wishes to acquire a security interest. Of course, undertaking appropriate due diligence prior to closing the transaction concerned and/or

requiring appropriate representations, warranties and indemnities (among other contractual provisions) in the relevant transaction documents may also provide a measure of protection (risk mitigation) to the secured party.

Protection Against Future Liens. Again, because the lien created by Section 3068 of the Civil Code is dependent upon possession by the lienor, the best way for a secured party to protect against the lien arising in the future is to obtain possession of any Qualifying Vehicle in which it has a security interest. If possession by the secured party is not feasible, appropriate covenants (among other contractual provisions) will provide at least some measure of protection (risk mitigation) to the secured party. Ultimately, however, such covenants cannot prevent the debtor from breaching its agreement with the secured party and permitting a Qualifying Vehicle in which the secured party has a security interest to become subject to the lien created under Section 3068 of the Civil Code. As noted above, such lien will be prior in right to the security interest in favor of the secured party.

Miscellaneous:

Sections 3071, 3072 and 3073 of the Civil Code contain detailed procedures regarding lien sales and various related matters, including applications for authorization to conduct a lien sale, notices to registered owners and other persons, and the disposition of proceeds.

3. Carriers' Liens

- a. Carrier's lien under Commercial Code Section 7307.

[TO BE ADDED IN SUBSEQUENT DRAFT]

- b. Carrier's liens for freightage under Civil Code Section 2144.

[TO BE ADDED IN SUBSEQUENT DRAFT]

4. Other Liens for Services

- a. Liens Arising under Civil Code § 3051 and § 3051.5

[TO BE ADDED IN SUBSEQUENT DRAFT]

- b. Jeweler's Lien.

[TO BE ADDED IN SUBSEQUENT DRAFT]

- c. Lien of Mining Claimant under Civil Code 3060.

[TO BE ADDED IN SUBSEQUENT DRAFT]

- d. Logger's and Lumber-Millman's Liens.

[TO BE ADDED IN SUBSEQUENT DRAFT]

- e. Factor's lien under Civil Code Section 3053.

[TO BE ADDED IN SUBSEQUENT DRAFT]

- f. Lien for Aircraft Repairs (Business & Professions Code §9798.1).

[TO BE ADDED IN SUBSEQUENT DRAFT]

- g. State Lien In Connection With The Operation Of Airport Or Air Navigation Facility By State (Arising Under Public Utilities Code § 21640).

[TO BE ADDED IN SUBSEQUENT DRAFT]

- h. Customs broker's lien (Arising Under 19 U.S.C. § 1564 (2005), As Amended).

[TO BE ADDED IN SUBSEQUENT DRAFT]

C. **LIENS ARISING IN LITIGATION**

1. **Attachment of inventory by taking possession through a "keeper" under Code of Civil Procedure Section 488.395.**

[TO BE ADDED IN SUBSEQUENT DRAFT]

2. **Judgment and Execution Orders (Arising Under California Code Of Civil Procedure §§708.110, 708.120 and 708.205)**

How the Enforcement Liens Arise/Attach:

California's Enforcement of Judgments Law (the "EJL"), codified at CCP §§680.010 through 724.260, contains three provisions that create liens relating to the procedure for conducting an examination of the judgment debtor's property to aid the court in enforcement of many monetary judgments. A lien cannot be created for a monetary judgment that is payable in installments unless all of the installments have become due and payable or a court has ordered otherwise pursuant to CCP §697.540(b). Each lien lasts for one year after the order.

The first type of lien attaches to the personal property of a judgment debtor before the conduct of the examination (referred to herein as the "Pre-Examination Lien"). This lien is created automatically under CCP §708.110 when the judgment creditor serves the judgment debtor with a copy of the court order for examination. The second lien attaches to the personal property of a judgment debtor that is being held by a third party or to the judgment debtor's interest in a debt owed to it by a third party (referred to herein as the "Pre-Examination Third

Party Lien”). This lien is created automatically under CCP §708.120 if (1) the judgment creditor demonstrates to the court that a third party has possession or control of property in which the judgment debtor has an interest or that a third party is indebted to the judgment debtor in an amount greater than \$250 and (2) the judgment creditor serves the order of examination on the judgment debtor and the third party along with fees for the third party’s mileage necessary to attend the examination proceeding. The two pre-examination liens are against all of the debtor’s property. The third lien is created under CCP §708.205 against those items of the debtor (whether held by the debtor or a third party) that the court determines after examination shall be applied to satisfy the judgment (referred to herein as the “Post-Examination Lien”). These three liens are collectively referred to herein as the “Examination Liens.”

Perfection of the Enforcement Liens:

The EJM does not mention or require perfection of an Examination Lien; the only requirement is that the lien be “created”. See *In re Hilde*, 120 F.3d 950, 954 (9th Cir. 1997).

Priority of the Enforcement Liens:

The EJM contains a limited number of provisions addressing the priority of execution liens including the Examination Liens but does specifically address the extent to which Examination Liens remain in effect as to property that is subsequently transferred.

The EJM provides that priority of the Pre-Examination Third Party Liens will date from the service of the examination order on the judgment debtor if that order described the property in the hands of the third party. CCP §708.120(c). If a lien is created on property pursuant to the EJM while an earlier lien under the EJM is still in effect, the priority of the later lien relates back to the date the earlier lien was created. CCP §697.020(b). This application of the “relation back” doctrine preserves the judgment creditor’s priority as of the time of creation of the first in a series of overlapping liens on the same property.

Other than application of the “relation back” doctrine, the EJM is silent on the subject of priority of Examination Liens. The California Law Revision Commission Report recommending the EJM’s adoption refers to the provisions in Civil Code §§ 2897-2899 concerning the priority of liens. 16 Cal.L.Rev.Comm. Reports 1273 (1982) (comment to CCP §697.020). Civil Code §2897 provides that “[other] things being equal, different liens upon the same property have priority according to the time of their creation....” However, the Civil Code is not the only California statutory authority on the issue of priority. Commercial Code §9317(a)(2) states that an execution lien, such as an Examination Lien, on personal property takes priority over an unperfected security interest but is subordinated to a security interest that is perfected before the creation of the Examination Lien. In addition, Commercial Code §9323(b) states that a security

interest is subordinate to the rights of a person who becomes a lien creditor to the extent that the security interest secures an advance made more than 45 days after such person becomes a lien creditor. However, there are three circumstances in which the security interest securing the advance would not be subordinated to the Examination Lien (or other execution lien): (1) if the advance was made without knowledge of the Examination Lien, (2) if the advance was made pursuant to a commitment that was entered into without knowledge of the Examination Lien or (3) the security interest was held by a consignor or a buyer of accounts, chattel paper, payment intangibles or promissory notes. Commercial Code §9323(b) and (c).

The Examination Liens, like other execution liens, take priority over federal tax liens unless proper notice of the federal tax lien was filed before the Examination Lien was created. 26 U.S.C. §6323(a). The EJP does not address the relative priority of state tax claims over the Enforcement Liens. But the pre-EJP rule was that the priority as between state tax claims and execution liens such as the Examination Liens depended on the particular statute under which the state tax claim was authorized. 6 Cal. Proc. (4th), Provisional Remedies, §187. It is not clear whether that pre-EJP rule still applies, although there is no reason to believe that it does not.

Under the EJP property that becomes subject to an Examination Lien remains subject to that Examination Lien after a transfer or encumbrance unless that transfer or encumbrance was made to one of the following persons (CCP §697.740):

- (1) A person who acquires an interest in the property for reasonably equivalent value without knowledge of the lien;
- (2) A buyer in the ordinary course of business who would take free of a security interest under Commercial Code §9320;
- (3) A lessee or licensee in the ordinary course of business who would take free of a security interest under Commercial Code §9321;
- (4) A holder in due course (as defined in Commercial Code § 3302) of a negotiable instrument within the meaning of Commercial Code § 3104;
- (5) A holder to whom a negotiable document of title has been duly negotiated within the meaning of Commercial Code §7501;
- (6) A protected purchaser of a security as defined in Commercial Code §8303 or a person entitled to the benefits of Commercial Code §§8502 or 8510;
- (7) A purchaser of chattel paper or an instrument who gives new value and takes possession of the chattel paper or instrument in the ordinary course of business;

- (8) A holder of a purchase money security interest under Commercial Code §9103;
- (9) A collecting bank holding a security interest in items being collected , accompanying documents and proceeds pursuant to Commercial Code §4210;
- (10) A person who acquires any right or interest in letters of credit, advices of credit or money; or
- (11) A person who acquires any right or interest in property subject to a certificate of title statute of another jurisdiction under the law of which indication of a security interest on the certificate of title is required as a condition of perfection of the security interest.

The Obligations Secured by the Lien:

The Examination Liens secure the amount of the underlying monetary judgment. See CCP §708.205 (referring to the amount secured by a Post-Examination Lien). The Pre-Examination Lien and Pre-Examination Third Party Lien will expire one year from the date of the court's order of examination (not the date of service) unless extended or sooner terminated by the court. CCP §§708.110(d), 708.120(c).

The Collateral Subject to the Lien:

Any personal property could be subject to an Examination Lien unless such personal property falls within an exemption. CCP Sections 704.010 through 704.210 exempt various types of property of natural persons from the Examination Liens to allow the judgment debtor to protect himself and his family and the court also may grant an exemption based upon need. CCP §703.115. The enumerated exemptions include the first \$2400 in value of motor vehicles, household furnishings at the judgment debtor's principal residence, the first \$6,075 in value of jewelry, heirlooms and works of art and life, health, disability, unemployment, workers' compensation and insurance benefits. See CCP §§704.010 -- 704.210. The dollar thresholds in the various enumerated exemptions are subject to triennial adjustments based upon changes in the California Consumer Price Index for All Urban Consumers. CCP §703.150(b), (c). The enumerated exemptions are not intended to be exclusive. See 703.030(a) (referring to exemptions under other statutes); See also 703.050 (regarding the effective date of exemption statutes that exemptions may be claimed under). Exemptions may be waived by the judgment debtor at the time the exemption can be claimed but contractual or other prior waivers of the exemptions are invalid. CCP §§703.030, 703.040.

An assignor for the benefit of creditors is entitled to the exemptions that could be used against the Examination Liens. CCP §1801.

Property subject to a public trust is not subject to execution. *El Camino Irr. Dist. v. El Camino Land Corp.* (1938) 12 C.2d 378, 382.

The Classes of Secured Party/Debtor Subject to the Lien:

Any debtor could become subject to the Examination Liens including state or municipal entities. In addition, as discussed above natural persons and assignors for the benefit of creditors are entitled to exempt various types of property from the Examination Lien.

How a Secured Party Can Maintain Its Priority or Protect its Lien Against the Hidden Lien, Including Recommended Due Diligence:

A secured party can protect itself to some extent by searching for judgments prior to making any new loans or additional advances. If a judgment is discovered, the secured party can require the borrower to make a representation that neither it nor any third party in possession of its property has not been served with any orders to appear at a post-judgment examination. A covenant requiring the borrower to report any judgments and the service of post-judgment examination orders may also provide some protection.

3. **Liens arising in creditor's suit under Code of Civil Procedure Section 708.250.**

How the Lien Arises/Attaches:

The statutory provisions in California for the enforcement of judgments not only authorize a levy by a judgment creditor against a third person indebted to or in possession of property of the judgment debtor, but also authorize the judgment creditor to bring suit against those third persons, if necessary or appropriate. If a judgment creditor elects to file a creditor suit against a third party to recover either property of the judgment debtor held by this third party or a debt owed to the judgment debtor by the third party, Section 708.250 of the California Code of Civil Procedure provides that an equitable lien is created on the property or debt which is the subject of the action upon the service of a summons on the third party. *Wardley Development, Inc. v. The Superior Court of Los Angeles County*, 213 Cal. App. 3d 391, 395 (App. Ct. CA 1989).

Perfection of the Lien:

The service of the summons creates the statutory lien and California law does not provide for any additional step to perfect this lien.

Priority of Lien:

Although the service of the summons in a creditor suit creates a statutory lien on the property which is the subject of that action and no further action is required by the judgment creditor to establish or perfect that lien, there is no indication in the

statute that would give that lien any priority over an existing perfected security interest in that property.

A creditor who acquires a lien under Section 708.250 “acquires only an equitable lien on such assets and a priority over general creditors” who have not served a summons of the type covered by Section 708.250. *Wardley*, 398. The equitable lien “is superior to general creditors or assignees of the property subject to the lien . . . [but] the lien does not give the judgment creditor an immediate right to compel transfer of the subject property to him.” *Id.* *Wardley* states that it would be unjust to allow a Section 708.250 lien “to set lien priority over other creditors who must establish the validity or probable validity of their claims before they are entitled to establish lien priority of record”, suggesting that such liens may not have priority over subsequent secured liens. *Id.*

Obligation Secured by the Lien:

The obligations secured by the lien created pursuant to Section 708.250 are the amount of debt owed by such third party to the judgment debtor and/or the amount of property of the judgment debtor held by such third party.

The lien prevents the third party from distributing assets in derogation of the lien, as such action makes the third party personally liable to the lienholder for the amount of such distribution, up to the amount of the lienholder’s claim. See *Wardley*, 398.

The Collateral Subject to the Lien:

The lien created pursuant to Section 708.250 covers the interest of the judgment debtor in the property or on the debt owed to the judgment debtor that is the subject of the creditor action.

How a Secured Party Can Maintain its Priority or Protect Its Lien Against the Hidden Lien, Including Recommended Due Diligence:

From the standpoint of a secured creditor of the judgment debtor with a perfected security interest in the assets of the judgment debtor, this statutory lien does not prime the existing perfected security interest. Even if the prior security interest is unperfected, Section 2897 of the Civil Code generally provides that, all other things being equal, different liens on the same property have priority according to the time of their creation and therefore the prior secured creditor should have priority over the judgment creditor’s lien.

Although a Section 708.250 lien creditor might claim priority over subsequent secured creditors, the language of *Wardley* renders such a claim of priority suspect, due to the extreme weakness of the Section 708.250 lien.

If a secured creditor of the judgment debtor learns of any such creditor action, or a levy by the judgment creditor on any asset of the judgment debtor, the secured

creditor may want to consider filing a third party claim under California law (Code of Civil Procedure Section 720.010 et seq.) in order to establish its priority in the asset.

From the standpoint of a secured creditor of the third party defendant in this creditor action, that is the entity that holds property in which the judgment debtor has an interest, or owes a debt to the judgment debtor, there should not be any adverse impact since the basis of the creditor action is that this is property of the judgment debtor and not the person holding the asset. In some instances property may be owned not only by the judgment debtor but also by the third person holding the asset and in that situation, a secured creditor of the third party may want to file a third party claim to establish its lien position with respect to the interest of its debtor.

4. **Liens arising under charging order under Code of Civil Procedure Section 708.320 and Corporations Code Sections 16504 and 17302.**

How the Lien Arises/Attaches:

General Partnership. Under the Uniform Partnership Act of 1994, a partner is not a co-owner of partnership property and has no transferable interest in the property. Corporations Code § 16501. A partner's only transferable interest is that partner's personal property interest in a share of the partnership's profits and losses and the right to receive distributions. Corporations Code § 16502. In order to reach a debtor's partnership interest, the judgment creditor must obtain a court order charging that interest with the amount of the judgment. Code of Civil Procedure §§699.720(a)(2); 708.310. The charging order replaces the levy of execution as a remedy for reaching a partnership interest.

Corporations Code § 16504 provides the exclusive remedy by which a judgment creditor of a partner or partner's transferee may satisfy a judgment out of the judgment debtor's transferable interest in the partnership. Corporations Code § 16504(e). Corporations Code § 16504(a) provides:

On application by a judgment creditor of a partner or of a partner's transferee, a court having jurisdiction may charge the transferable interest of the judgment debtor to satisfy the judgment. The court may appoint a receiver of the share of the distributions due or to become due to the judgment debtor in respect of the partnership and make all other orders, directions, accounts, and inquiries the judgment debtor might have made or that the circumstances of the case may require.

A charging order constitutes a lien on the judgment debtor's transferable interest in the partnership. The court may order a foreclosure of the interest subject to the charging order at any time. The purchaser at the foreclosure sale has the rights of a transferee. Corporations Code § 16504(b). The partner is not deprived of its

rights under exemption laws with respect to the partner's interest in the partnership. Corporations Code § 16504(d).

Service of a notice of motion for a charging order on the judgment debtor and all partners or the partnership creates a lien on the judgment debtor's partnership interest. Code of Civil Procedure § 708.320(a). The lien continues under the terms of the court's charging order until the judgment becomes unenforceable. The lien also continues notwithstanding the transfer or encumbrance of the partnership interest, unless the transfer or encumbrance is made to a person listed in Code of Civil Procedure § 697.740. But, if the court refuses to issue a charging order (or if the judgment is stayed pending appeal), the lien is extinguished. Code of Civil Procedure §§ 697.030, 697.040, 708.320(b).

Limited Partnership. Under the California Uniform Limited Partnership Act of 2008, a limited partnership is an entity distinct from its partners. Corporations Code § 15901.04(a). The only interest of a partner which is transferable is the partner's right to receive distributions. Corporations Code § 15907.01. In order to reach a debtor's limited partnership interest, the judgment creditor must obtain a court order charging that interest with the amount of the judgment. Code of Civil Procedure §§ 699.720(a)(2); 708.310. The charging order replaces the levy of execution as a remedy for reaching a limited partnership interest.

Corporations Code § 15903.03 provides the exclusive remedy by which a judgment creditor of a limited partner or limited partner's transferee may satisfy a judgment out of the judgment debtor's transferable interest in the partnership.²

Under the California Uniform Limited Partnership Act of 2008, a charging order on a limited partnership interest only gives the judgment creditor the rights of an assignee of the interest. Corporations Code § 15907.03(a). The limited partnership is not dissolved; nor is the judgment creditor entitled to become a limited partner or exercise any rights of a limited partner. No creditor of a partner has any right to obtain possession or otherwise exercise legal or equitable remedies with respect to the property of a limited partnership. Corporations Code § 15907.03(f).

A charging order constitutes a lien on the judgment debtor's limited partnership interest in the partnership. Code of Civil Procedure § 708.320.

Service of a notice of motion for a charging order on the judgment debtor and all partners or the partnership creates a lien on the judgment debtor's limited partnership interest. Code of Civil Procedure § 708.320(a). The lien continues under the terms of the court's charging order until the judgment becomes unenforceable. The lien also continues notwithstanding the transfer or encumbrance of the partnership interest, unless the transfer or encumbrance is made to a person listed in Code of Civil Procedure § 697.740. But, if the court refuses to issue a charging order (or if the judgment is stayed pending appeal), the lien is extinguished. Code of Civil Procedure §§ 697.030, 697.040, 708.320(b).

Limited Liability Company Interest. Under the Beverly-Killea Limited Liability Company Act, a membership interest and an economic interest in a limited liability company constitute personal property of the member or assignee. Corporations Code § 17300. A member or assignee has no interest in specific limited liability company property. Corporations Code § 17300. In order to reach a debtor's limited liability interest, the judgment creditor must obtain a court order charging that interest with the amount of the judgment. Code of Civil Procedure §§ 699.720(a)(2); 708.310. The charging order replaces the levy of execution as a remedy for reaching a membership interest.

Corporations Code § 17302 provides the exclusive remedy by which a judgment creditor of a member or member's assignee may satisfy a judgment out of the judgment debtor's transferable interest in the limited liability company. Corporations Code § 17302(e). Corporations Code § 17302(a) provides:

On application by a judgment creditor of a member or of a member's assignee, a court having jurisdiction may charge the assignable membership interest of the judgment debtor to satisfy the judgment. The court may appoint a receiver of the share of the distributions due or to become due to the judgment debtor in respect to the limited liability company and may make all other orders, directions, accounts, and inquiries that the judgment debtor might have made or that the circumstances of the case may require.

A charging order constitutes a lien on the judgment debtor's assignable interest in the limited liability company, and the court may order a foreclosure of the interest subject to the charging order at any time. Corporations Code § 17302(b). The purchaser at the foreclosure sale has the rights of an assignee. Corporations Code § 17302(b). The member is not deprived of its rights under exemption laws with respect to the member's interest in the limited liability company. Corporations Code § 17302(d).

Service of a notice of motion for a charging order on the judgment debtor and all of the members of the limited liability company creates a lien on the judgment debtor's membership interest. Code of Civil Procedure § 708.320(a). The lien continues under the terms of the court's charging order until the judgment becomes unenforceable. The lien also continues notwithstanding the transfer or encumbrance of the membership interest, unless the transfer or encumbrance is made to a person listed in Code of Civil Procedure § 697.740. But, if the court refuses to issue a charging order (or if the judgment is stayed pending appeal), the lien is extinguished. Code of Civil Procedure §§ 697.030, 697.040, 708.320(b).

Perfection of the Lien:

A lien on a judgment debtor's interest in a partnership or limited liability company is created by service of a notice of motion for a charging order on the judgment debtor and either (a) all partners or the partnership; or (b) all members

or the limited liability company. Code of Civil Procedure § 708.320(a). The lien continues under the terms of the court's charging order until the judgment becomes unenforceable; however, if the court refuses to issue a charging order (or if the judgment is stayed pending appeal), the lien is extinguished. Code of Civil Procedure §§ 697.030, 697.040, 708.320(b).

Priority of the Lien:

A lien arising under Code of Civil Procedure § 708.320 is subject to a prior perfected security interest in a partnership or limited liability company interest.³ The Legislative Committee Comments to Code of Civil Procedure § 697.020 state that Section 697.020 provides "the general rule regarding the relation back of liens to preserve the judgment creditor's priority as of the time of the creation of the first in a series of overlapping liens on the same property." Thus, "Subdivision (c) of Section 697.020 makes clear that the relation back doctrine does not affect the priority or rights of a third person established while the earlier lien was in effect."

The Obligations Secured by the Lien:

The lien created under Code of Civil Procedure § 708.320 secures the amount necessary to satisfy the money judgment. Code of Civil Procedure § 697.010.

The Collateral Subject to the Lien:

The lien created under Code of Civil Procedure § 708.320 is applicable to the judgment debtor's interest in a partnership or limited liability company, i.e. a share of the partnership's profits and losses and the right to receive distributions, and a share of the distributions due or to become due to the judgment debtor in respect to the limited liability company.

The Classes of Secured Party/Debtor Subject to the Lien:

Secured parties who take as collateral a debtor's interest in either a partnership or a limited liability company are subject to the hidden lien under Code of Civil Procedure § 708.320.

How a Secured Party Can Maintain Its Priority or Protect its Lien Against the Hidden Lien, Including Recommended Due Diligence:

Secured lenders can protect themselves against the hidden lien created under Code of Civil Procedure § 708.320 by (a) performing a judgment lien search prior to funding its loan to confirm that there are no other liens on the partnership or limited liability company interest; and (b) require the debtor to represent and warrant that the debtor is not a party to any litigation, nor has a judgment been entered against the debtor that has not been satisfied in full.

Miscellaneous:

The interest of a partner in a partnership or member in a limited liability company is not subject to execution if the partnership or the limited liability company is not a judgment debtor. Code of Civil Procedure § 699.720(a)(2). The exclusive remedy by which a judgment creditor of a partner or member may satisfy a judgment out of the judgment debtor's transferable interest in the partnership or limited liability company is a charging order.

5. **Liens for money owed to judgment debtor by public entity under Civil Procedure Section 708.780.**

Statutory Framework:

Code of Civil Procedure §708.780, subdivision (a) provides as follows:

Filing of the abstract or certified copy of the judgment and the affidavit pursuant to this article creates a lien on the money owing and unpaid to the judgment debtor by the public entity in an amount equal to that which may properly be applied to the satisfaction of the money judgment under this article.

How the Lien Arises/Attaches:

If a public entity owes money to a judgment debtor, the obligation of the public entity may be applied to the satisfaction of the money judgment against the judgment debtor only in the manner provided by CCP Article 8 (CCP §§708.710 through 708.795). CCP §708.720(a). "Public entity" means the State of California, any county, city, district, public authority, public agency, and any other political subdivision in the State of California. CCP §708.710. CCP Article 8 does not apply to the garnishment of wages of a public officer or employee or if the obligation of the public entity to pay money to the judgment debtor is the subject of a pending action or special proceeding. CCP §708.720. Except as to sums due and unpaid under a judgment of support, CCP Article 8 does not authorize a filing against an overpayment of tax, penalty or interest, or interest allowable with respect to an overpayment, under the Revenue and Taxation Code or the Unemployment Insurance Code. CCP §708.795.

If money is owing and unpaid to the judgment debtor by a public entity, the judgment creditor may file, in the manner described in the next paragraph, an abstract of the money judgment or a certified copy of the money judgment, together with an affidavit that states that the judgment creditor desires the relief provided by CCP Article 8 and states the exact amount then required to satisfy the judgment. The judgment creditor may state in the affidavit any fact tending to establish the identity of the judgment creditor. CCP §708.730(a). Promptly after filing the abstract or certified copy of the judgment and the affidavit with the public entity, the judgment creditor shall serve notice of the filing on the judgment debtor. Service shall be made personally or by mail. CCP §708.730(b).

If money is owing and unpaid to the judgment debtor by a state agency (defined in CCP §708.710(d)), the judgment creditor shall file the abstract or certified copy

of the judgment and the affidavit with the state agency owing the money to the judgment debtor prior to the time the state agency presents the claim of the judgment debtor to the Controller. CCP §708.740(a). If money is owing and unpaid to the judgment debtor by a public entity other than a state agency, the judgment creditor shall file the abstract or certified copy of the judgment and the affidavit with the auditor of the public entity or, if there is no auditor, with the official whose duty corresponds to that of auditor. CCP §708.750. Upon filing the abstract or certified copy of the judgment and the affidavit, the judgment creditor shall pay a fee of \$6 to the public entity with which it is filed. CCP §708.785. Additional special procedures apply if the lien of the judgment creditor is created against a lottery prize to be paid in annual installments (CCP §708.755) or if the judgment debtor is a contractor upon a public work (CCP §708.760).

The Controller (in the case of a state agency) or auditor (in the case of other public entities) shall deposit with the court the amount due the judgment debtor (after deducting an amount sufficient to reimburse the public entity for any amounts advanced to the judgment debtor or owed by the judgment debtor to the public entity) required to satisfy the money judgment as shown by the affidavit in full or to the greatest extent, and pay the balance thereof, if any, to the judgment debtor. CCP §708.740(c); CCP §708.750. Promptly after deposit with the court by the public entity, the court clerk shall cause a notice of deposit to be served on the judgment debtor. Within 10 days after service of the notice of deposit, the judgment debtor may file with the court a claim of exemption. CCP §708.770.

Different procedures apply where the judgment is for support. See, e.g., CCP §708.730(c).

Perfection of the Lien:

CCP §708.780 provides that filing the judgment and affidavit pursuant to CCP Article 8 “creates” a lien. The statute does not provide for any additional steps to be taken to perfect the lien.

Priority of the Lien:

Priority of the lien may be governed by Commercial Code §9317, which provides generally that a security interest is subordinate to the rights of a person that becomes a lien creditor before the time the security interest is perfected. Under Commercial Code §9102(a)(52), “lien creditor” includes a creditor that has acquired a lien on the property involved by attachment, levy or the like. It is uncertain whether a judgment creditor who has acquired a lien under CCP §708.780 is a “lien creditor” because the judgment creditor acquires the lien by filing with the public entity rather than through a judicial process. If the judgment creditor is not a “lien creditor,” then it may achieve priority under the common law’s “time of creation” principle codified in Civil Code §2897 (under this principle, where there are conflicting liens that are in all other respects equal, the priority given to a lien is based on when it was created).

Obligations Secured by the Lien:

The lien created under CCP §708.780 secures the amount required to satisfy the money judgment in full, as shown by the affidavit filed with the public entity.

The Collateral Subject to the Lien:

The lien created under CCP §708.780 attaches to the money owing and unpaid to the judgment debtor by the public entity, subject to the limitations set forth in CCP Article 8. For example, the lien does not attach to tax refunds, unless the judgment is for support.

The Classes of Secured Party/Debtor Subject to the Lien:

All classes of secured parties and all classes of debtors are subject to the lien created under CCP §708.780.

How a Secured Party Can Maintain Its Priority or Protect its Lien Against the Hidden Lien, Including Recommended Due Diligence:

A secured creditor can obtain priority over the lien created under CCP §708.780 and protect itself against this hidden lien by (a) properly perfecting its security interest in accordance with Revised Article 9 of the Commercial Code, (b) performing a search of the applicable Secretary of State's Commercial Code filing records and each county where the borrower owns or leases any real property or fixtures prior to funding its loan to confirm that there are no judgments of record against the borrower, (c) requiring the borrower to represent and warrant that there are no outstanding judgments against it, and (d) requiring the borrower to represent and warrant that no public entity owes any money to the borrower, or if a public entity owes money to the borrower, requiring the borrower to provide a list of each such public entity including contact information. The secured creditor should then contact each such public entity to confirm that no judgment creditor of the borrower has made a filing pursuant to CCP Article 8.

Miscellaneous:

Unless there is a definite sum owing and unpaid by the public entity to the judgment debtor, there can be nothing upon which the lien can attach. However, provided that the existence of liability and the amount thereof is fixed and determined beyond the possibility of further dispute, such sum does not have to be fixed and established by a final judgment against the public entity. Department of Water and Power of City of Los Angeles v. Inyo Chemical Co., 16 Cal.2d 744, 108 P.2d 410 (1940).

D. AGRICULTURAL LIENS

1. Trust under Perishable Agricultural Commodities Act, 7 U.S.C. §§499 *et seq.*

[TO BE ADDED IN SUBSEQUENT DRAFT]

2. **Trust under Packers and Stockyards Act, 7 U.S.C. §§181 *et seq.***

[TO BE ADDED IN SUBSEQUENT DRAFT]

3. **Agricultural laborer's lien under Civil Code Section 3061.5.**

[TO BE ADDED IN SUBSEQUENT DRAFT]

E. **TAX AND OTHER GOVERNMENTAL LIENS**

1. **Federal tax liens arising under the Internal Revenue Code against “all property and rights to property, whether real or personal” that belong to the taxpayer, 26 U.S.C. §6321.**

Statutory Framework of The Federal Tax Lien:

Section 6321 of the Internal Revenue Code (26 U.S.C. §6321) provides:

“If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.”

IRC Section 6322 specifies the time at which this federal tax lien arises and its duration. IRC Section 6223 sets out important rules concerning the validity and priority of the lien vis-à-vis various parties, including a secured party holding a security interest subject to Division 9 of the California Uniform Commercial Code. Section 6325 sets forth rules concerning the release of the lien.

How The Federal Tax Lien Arises:

IRC Section 6321 states that failure to pay a tax due the United States after demand shall be a lien in favor of the United States against any property and rights to property of such person. Section 6322, however, states that “the lien imposed by Section 6321 shall arise at the time the assessment is made.”

Sections 6321 and 6322 appear inconsistent insofar as they suggest two different points for the attachment of the federal tax lien: Section 6321 speaks in terms of demand and failure to pay while Section 6322 speaks in terms of time of assessment. Notwithstanding such apparent inconsistency, case law is uniform in holding that Section 6322 fixes the attachment of the federal tax lien as of the date of assessment. See, eg., *U.S. v. Donahue Industries, Inc.*, 905 F.2d 1325, 1330-31 (9th Cir. 1990); *Noriega & Alexander v. U.S.*, 859 F.Supp.406, 409 (E.D. CA 1994). At the same time, the courts have also been clear that a demand for payment is required for the lien to be effective. See, eg., *In re Bertelt*, 206 B.R.

579, 582 (Bankr. MD Fla 1996); *Ind. Lumbermens' Mut. Ins. Co. v. Construction Alternatives, Inc.*, 161 BR 949, 951 (Bankr. S.D. OH), affd. 2 F3d. 670 (6th Cir. 1992). The apparent inconsistency between Section 6321 and 6322 can be reconciled first by recognizing that Section 6322 specifically addresses the time the lien while broader language of Section 6321 states the predicates for the lien to be effective: a demand and failure to pay are predicates to the validity of a tax lien, but the lien reaches all property of the taxpayer existing as of the "time of assessment" or arising thereafter.

IRS Form 4340 Certificate of Assessment and Payment is presumptive evidence that taxes have been duly assessed. See, *eg.*, *Hefti v. I.R.S.*, 8 F3d 1169, 1172 (7th Cir 1993); But see, *Huff vs. U.S.*, 10 F.3d 1440, 1445-46 (9th Cir 1993) cert. denied, 512 U.S. 1219 (1994). (IRS could not rely solely on Form 4340 to prove valid assessment where form did not specify date on which assessment was made).

Perfection of Federal Tax Lien:

Section 6323(a) provides that unless the IRS has recorded a notice of tax lien that complies with Sections 6323(f), a tax lien will not be valid against (*i.e.*, have priority over) the interest of a purchaser, holder of a security interest, mechanic's lien or judgment lien creditor. The filing of a notice of tax lien is required only to obtain priority over the classes of interests specified by Section 6323(a): the priority of the tax lien over other liens and interests (*eg.*, state tax liens) are determined under the principles of "first in time" and "choateness" without regard to a notice of the tax lien filing. (See discussion under "Priority of Lien").

Section 6323(f) set out rules on the content and place for filing the federal tax lien notice. Section 6323(f)(3) states that the form and content of the notice are to be prescribed by the Secretary, and -- of paramount significance -- that the notice shall be valid notwithstanding any other provision of law regarding the form or content of a notice of a lien. Section 6323(f)(5) states that the filing of a notice of tax lien is governed solely by the Internal Revenue Code. These provisions of Section 6323(f) make clear that the rules concerning the form, content and place of filing of the notice of tax lien contained in Section 6323 and the regulations promulgated hereunder preempt both state law -- including the California Uniform Commercial Code -- and other federal law.

Preemption of state law poses a number of challenges to the practitioner representing a secured party seeking to confirm the priority of its Article 9 security interest:

Priority Risks Associated with Debtor's Name:

A secured party seeking to perfect a security interest under Division 9 through the filing of a financing statement must use the debtor's correct name as specified in CUCC 9-503 in the filing statement. Pursuant to CUCC 9-506(c), an error in the

name of the debtor is not necessarily fatal to the effectiveness of the financing statement if a search of the records under the debtor's correct name using the filing office's standard search logic would disclose the financing statement. However, if a search using the filing office's standard search logic would not disclose the financing statement, it is "seriously misleading" and is not effective to establish the secured party's priority.

The sufficiency of the debtor's name in a notice of tax lien is not subject to the strictures of the filing office's standard search logic imposed by CUCC 9-506(c). Instead, the sufficiency of a debtor's name in a notice of tax lien is governed by a more lenient standard: whether a reasonable and diligent search would disclose the notice of the tax lien. While a practitioner need only conduct a search under the debtor's correct name using the filings office's standard search logic to search for other security interests governed by Division 9, the practitioner may be required to conduct searches using variants of the debtor's correct name to search for notices of federal tax lien. *See, eg, In re Spearing Tool and Mfg. Co.*, 412 F3d. 653 (6th Cir 2005), cert. den., 127 S.Ct. 41 (2006). Thus, failure of a search under the debtor's correct name as specified by CUCC 9-503 using the filing office's standard logic to disclose a notice of tax lien is not a sufficient basis to conclude that a tax lien is not entitled to priority.

Priority Risks Associated with Place of Filing:

Section 6323(f) prescribes different rules for the place of filing with respect to for real property and personal property.

For real property, the notice is to be filed in the one office as designated by state law in which the real property is physically located. In California, the filing office is the county recorder's office.

For personal property, the notice is to be filed in the one office designated under the laws of the State of the taxpayer's residence at the time the notice is filed. A corporation or partnership is deemed to reside at the location of its principal executive office of business.

While Section 6323(f)'s place of filing rules for personal property was intended to correspond to the plan of filing rules under the Uniform Commercial Code, the rules do not correspond to the revised Uniform Commercial Code now enacted. Under Section CUCC 9307, a "registered organization" is located under the state of the laws under which it is organized, not the jurisdiction of its principal place of business. Thus, a Delaware corporation is located in Delaware notwithstanding that its executive offices and principal place of business are located in California, and the practitioner must search for competing security interests in Delaware. This difference in filing requirements means that for "registered organizations" such as corporations and most partnerships, the practitioner must conduct a search for a notice of tax lien not only in the filing office of the state under which it is organized - - where all other security interests are recorded - - but all in the filing

office of the state in which the taxpayer's principal executive office of business in order to capture notices of tax liens.

Priority Risks Associated with Change in Taxpayer's "Residence":

A notice of tax lien is effective for a period of ten (10) years and thirty (30) from the date of assessment, but can be renewed by refiling during such period. The IRS is not required to refile its notice of tax lien within the ten (10) year period based on a change in the debtor taxpayer's residence. Thus the practitioner cannot rely on searches of the filing office of the state of the debtor's current residence, but must conduct searches in the state of the debtor's prior residences, i.e., all former principal executive office of business.

Priority of Federal Tax Lien:

The federal tax lien has existed, in one form or another, for over one hundred years. Prior to the Federal Tax Lien Act of 1966, the priority of the federal tax lien vis-à-vis other liens, was determined under the common law principles of "first in time is first in right" and "choateness". Application of these principles to resolve priority of lien rights proved problematic for secured lenders, particularly a lender sought to rely on a "floating lien" on accounts and inventory because the consensual lien could not attach and enjoy priority as to accounts and inventory not then in existence. As a consequence, a tax lien was deemed to have priority over existing security interests in accounts and inventory arising or acquired after the time the tax lien came into existence. In enacting Section 6323, Congress sought to achieve a certain balance between the rights of the United States and the rights of other lienholders -- including the lender with a "floating lien" -- that would accommodate the needs of commercial finance as well as other societal interests.

Section 6323(a) states the first basic rule of priority of the federal tax lien:

"the lien imposed by Section 6321 shall not be valid as against any purchaser, holder of a security interest, mechanics lien or, judgment lien creditor until notice thereof which meets the requirement of subsection (f) has been filed."

Section 6323(a) requires the IRS to "perfect" its lien by filing a notice of tax lien to enjoy priority, but only where the competing interest is that of a purchaser, holder of a security interest, judgment lien creditor or mechanic's lien. The priority of other liens, notably state tax liens and other statutory liens, is still determined under the common law principles of "first in time" and "choateness".

Sections 6323(b) through (d) delineate the priority of the tax lien where a notice of tax lien has been filed. Each of these subsections is discussed in further detail below:

Section 6323(b) is a quiltwork of special priority rules based on the nature of the collateral and/or the nature of the competing lien or interest. The provisions of 6323(b) provide separate rules for:

- Securities (b(1))
- Motor Vehicles (b(2))
- Personal Property purchased at retail (b(3))
- Personal property purchased at retail sale (b(4))
- Personal property subject to possessory lien (b(5))
- Real property taxes and assessments (b(6))
- Residential property subject to mechanic's liens (b(7))
- Attorneys liens (b(8))
- Insurance Contracts (b(9))
- Deposit-secured accounts (b(10))

Section 6323 (d) provides a limited priority for a security interest which comes into existence by reason of disbursements made before the 46th day after the date of filing of the notice of the tax lien. In order to enjoy priority under subsection (d):

- i. The disbursements must be made without actual notice or knowledge of the tax lien;
- ii. The security interest must be covered by the terms of a written agreement entered into before the tax lien filing;
- iii. The security interest is in property subject to the tax lien at the time of the tax lien filing; and
- iv. The security interest is protected under local laws (eg. Division 9 of the California Uniform Commercial Code) as of the time of the tax lien filing against a judgment lien arising from an unsecured obligation.

In sum, Section 6323(d) will provide continued priority for advances made without knowledge of the tax lien with the first 45 days after the tax lien filing in property existing as of the time of the tax lien filing. The priority provided by Section 6323(d) is limited to property existing as of the tax lien filing and does not extend to property acquired or coming into existence after the filing: priority does not extend to accounts or inventory acquired or arising within the 45 day period after the tax lien filing.

Section 6323(c)

In contrast to Section 6323(d), Section 6323 (c) provides priority as to both disbursements made and property acquired after the tax lien filing, but only for

certain transactions. In order to obtain priority under Section 6323(c), a security interest must satisfy four requirements:

- i. The security interest must have priority under local applicable law against a hypothetical judgment lien arising as of the time of the tax lien filing, out of an unsecured transaction.
- ii. The security interest must be created by a written agreement entered into before the tax lien filing;
- iii. The written agreement must constitute either a commercial transaction financing agreement, a real property construction or improvement financing agreement, or an obligatory disbursement agreement; and
- iv. The security interest is entitled to priority only to the extent it is in “qualified property”, a defined term whose scope varies depending on the category of written agreement involved.

- Obligatory Disbursement Agreement. An “obligatory disbursement agreement” is an agreement entered into by a person in the course of his trade or business to make disbursements, but only to the extent such disbursements are required by reason of the intervention of the rights of a person other than the taxpayer. This definition covers an agreement creating a suretyship-type relationship. For example, agreements granting a security interest to secure the taxpayer’s obligation to reimburse or indemnify the issuer of a letter of credit or performance bond or a guarantor qualify as “obligatory disbursement agreements.”

Where the security interest arises under an “obligatory disbursement agreement”, “qualified property” is limited to property subject to the lien as of the time of the tax lien filing together with property thereafter acquired to the extent its acquisition is directly traceable to the disbursements made under the obligatory disbursement agreement.

- Real Property Construction or Improvement Financing Agreement. A “real property construction or improvement financing agreement” means an agreement to make cash advances (the furnishing of goods or services is deemed a cash disbursement) to finance the construction or improvement of real property or a contract to be the same; or the raising or harvesting of a farm crop or livestock. Where the agreement is a “real property construction or improvement financing agreement”, “qualified property” is limited to the real property improved, the contract financed or where a crop or livestock is being financed, the crop or livestock in existence as of the time of notice of the tax lien.

- Commercial Transaction Financing Agreement. A “commercial transaction financing agreement” is an agreement entered into by a person in the course of his trade or business to make loans secured by or purchase “commercial financing security” acquired by the taxpayer in the ordinary course of its business,

provided that an agreement shall come within the definition only to the extent that the loan or purchase is made before the earlier of (i) the 46th day after the tax lien filing; or (ii) the date the lender/purchaser has actual notice or knowledge of the tax lien filing. “Commercial financing security” means commercial paper, accounts, mortgages or real property and inventory. Where the agreement is a commercial transaction financing agreement, “qualified property” is limited to “commercial financing security” acquired by the taxpayer before the 46th day after the tax lien filing. Thus, with respect to a security interest arising under a commercial transaction financing agreement, the lender/purchaser is afforded priority as both disbursements made (assuming no notice or knowledge of the tax lien filing) and property acquired before the 46th day after the tax lien filing.

Obligations Secured by Tax Lien:

Section 6321 provides that the tax lien secures the amount of “any tax”, together with any “interest, additional amount, addition to tax, or assessable penalty, together with any costs that may have accrued in addition thereto.” The case law confirms the broad scope of the tax lien: it covers all taxes due the United States (i.e., federal taxes) for which the debtor may be liable. See, *U.S. v. Cleavenger*, 325 F.Supp.871, 874-75 (N.D. Ind. 1971). This tax lien covers federal income tax as well as all federal withholding taxes.

While the language of Section 6321 is broad enough to encompass all federal taxes for which a person may be liable, including estate taxes, Section 6324 creates specific liens for estate taxes and gift taxes that are of an “in rem” nature, that is, limited to the value of the property received. Estate liens under Section 6324 attach upon the death of the decedent and do not require assessment or demand to be effective, although pursuant to Section 6324(c)(1), such lien will have priority over liens to the same extent of the general tax lien per Section 6323(b).

Property Subject to Federal Tax Lien:

The lien arising under Section 6321 attaches to “all property and rights to property, whether real or personal” of the debtor. The language of the statute is intentionally broad and intended to reach every species of right or interest protected by law and having an exchangeable value. *Drye v. U.S.* 528 U.S. 49, 56 (1999); See also, *In Re Raihl*, 152 BR 615, 617 (9th Cir.BAP 1993). The federal tax lien attaches to all property of the person liable for the tax, including property otherwise exempt from levy or execution under state or federal law. See, *Medaris v. U.S.*, 884 F.2nd 832, 833-34 (5th Cir. 1989) (Texas statute exempting spouse’s earnings from debtor spouse’s creditors ineffective as to a tax lien); *In Re Raihl*, 152 B.R. 615 (9th Cir. BAP 1993) (pension funds subject to tax lien even though plans qualified as spend thrift trust and not property of bankruptcy estate).

The Classes of Lienor And Lienee Subject to Lien:

The United States is the only party entitled to assert a federal tax lien. Any individual or legal entity that is liable for a federal tax is subject to having its property encumbered by a federal tax lien arising under Section 6321, and Section 6324 creates a tax lien upon the property of a probate estate. The property of a party other than the “person liable to pay” the tax may be encumbered by a federal tax lien under an alter ego/nominee theory. See, eg. *Cody vs. U.S.* 348 F. Supp 2d. 682 (E.D. VA 2004).

Measures to Protect Against Risks of Federal Tax Lien:

Due Diligence - A secured creditor should consider conducting the following due diligence in connection with the priority risks posed by a potential federal tax lien:

1. Conduct UCC searches in the filing office of the state of debtor’s residence. In the case of a debtor that is not an individual, this includes a search in all states wherein the debtor’s “principal executive office of business”.
2. To comply with the “reasonable and diligent” standard applicable to notices of federal tax lien, conduct UCC searches not only under the debtor’s correct name, but commonly occurring variants. This may involve both searches under the filing offices standard search logic as well as searching by searches that employ broader, more error tolerant, search logic.
3. Search in filing offices of states of debtor’s former residences (at least for 10 years).

Standard provisions that a secured party may include in its security agreement with respect to protecting against losing priority to a federal tax lien include:

1. Having the debtor covenant to timely pay all federal taxes and to promptly notify secured party of any (i) failure to pay taxes; (ii) assessment of taxes; or (iii) notice of tax lien.
2. Making a failure to pay taxes (subject to an exception for taxes disputed in good faith), an assessment of taxes or the filing of a notice of tax lien an event of default.
3. Entitling secured party to pay the amount to discharge a tax lien and add such amounts to the principal and interest to its secured obligations.

In addition to requiring the debtor to covenant with respect to the tax assessments and notices of tax lien, the secured party should consider making periodic searches of the filing office of the state of the debtor’s residence for potential notices of tax lien.

2. **Unpaid sales and use taxes under Rev. & Tax. Code Section 6757.**
[TO BE ADDED IN SUBSEQUENT DRAFT]
3. **Environmental contamination giving rise to liens under the Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. §§9601 et seq. (CERCLA).**
[TO BE ADDED IN SUBSEQUENT DRAFT]
4. **ERISA liens under 29 U.S.C. §1368.**
[TO BE ADDED IN SUBSEQUENT DRAFT]
5. **Lien for public employees' retirement systems under Government Code Section 20574.**

Statutory Framework:

Government Code §20574 provides in full:

A terminated agency shall be liable to the system for any deficit in funding for earned benefits, as determined pursuant to Section 20577, interest at the actuarial rate from the date of termination to the date the agency pays the system, and for reasonable and necessary costs of collection, including attorney's fees. The board shall have a lien on the assets of a terminated contracting agency, subject only to a prior lien for wages, in an amount equal to the actuarially determined deficit in funding for earned benefits of the employee members of the agency, interest, and collection costs. The assets shall also be available to pay actual costs, including attorneys' fees, necessarily expended for collection of the lien.

How the Lien Arises/Attaches:

The lien arises if a contracting agency remains liable to the retirement system for a deficit in funding for earned benefits after such contracting agency's contract with the Board of Administration of the Public Employees' Retirement System (the "Board") for retirement benefits has been terminated. Such contract may be terminated by either the contracting agency or the Board in the following circumstances. A contracting agency generally has the right to terminate such contract if the contract has been in effect for at least five years and the governing body of such contracting agency adopts a resolution or ordinance, with the affirmative vote of two-thirds of the members of such governing body, terminating such contract. The Board has the right to terminate such contract by a majority vote of its members if the contracting agency fails for thirty days after demand by the Board to pay any installment of contributions required by its contract or fails to file any required information, or if the Board determines that the agency is no longer in existence.

Perfection of the Lien:

The statute is silent on how to perfect the lien or whether perfection is necessary.

Priority of the Lien:

The statute provides that the lien is subject only to a prior lien for wages owed by the terminated contracting agency.

The Obligations Secured by the Lien:

The lien secures the deficit in funding for earned benefits owed by the contracting agency as determined pursuant to Government Code §20577, accruing interest and collection costs.

The Collateral Subject to the Lien:

The statute provides that the Board shall have a lien on the assets of the contracting agency. Though not entirely clear, the lien presumably is a blanket lien over all assets of the contracting agency.

The Classes of Secured Party/Debtor Subject to the Lien:

The secured party is the Board. The debtor is the contracting agency which is defined as any public agency that has elected to have all or any part of its employees become members of the retirement system and that has contracted with the Board for that purpose. Contracting agency is also defined as any county office of education, school district, or community college district that has elected to have all or part of its employees participate in a risk pool and that has contracted with the Board for that purpose.

How a Secured Party Can Maintain Its Priority or Protect its Lien Against the Hidden Lien, Including Recommended Due Diligence:

The risk of being primed by this lien only arises if the debtor is a public agency. In such a circumstance, the secured party should ensure that the debtor has not recently terminated a contract for retirement benefits with the Board where the debtor has continuing liabilities. It may be prudent to retain the advice of an attorney who specializes in the area of public employee benefits to confirm one's understanding.

6. Liens for unpaid wages pursuant to the "hot goods" section of the federal Fair Labor Standards Act, 29 U.S.C. §215(a)(1).

Statutory Framework:

Section 215(a)(1) of the Fair Labor Standards Act provides that:

“...[I]t shall be unlawful for any person to transport, offer for transportation, ship, deliver, or sell in commerce, or to ship, deliver, or sell with knowledge that shipment or delivery or sale thereof in commerce is intended, any goods in the production of which any employee was employed in violation of Section 206 or Section 207 of this title, or in violation of any regulation or order of the Secretary issued under Section 214 of this title; except that no provision of this chapter shall impose any liability upon any common carrier for the transportation in commerce in the regular course of its business of any goods not produced by such common carrier, and no provision of this chapter shall excuse any common carrier from its obligation to accept any goods for transportation; and except that any such transportation, offer, shipment, delivery, or sale of such goods by a purchaser who acquired them in good faith in reliance on written assurance from the producer that the goods were produced in compliance with the requirements of this chapter, and who acquired such goods for value without notice of any such violation, shall not be deemed unlawful;”

How the Lien Arises / Attaches:

In Citicorp Industrial Credit, Inc. v. Brock, Secretary of Labor, 483 U.S. 27 (1987), the Supreme Court held that no lien is actually created under 29 U.S.C. § 215(a)(1) of the Fair Labor Standards Act (29 U.S.C. §§201-219) (the “FLSA” or the “Act”), which is commonly known as the “Hot Goods” provision of the FLSA. Rather, the possessor of goods manufactured in violation of the minimum wage or overtime requirements of the FLSA may be enjoined from selling, transferring, shipping or otherwise injecting those items into interstate commerce until the employees involved in the production of those goods are paid.

In *Citicorp*, the Supreme Court considered whether the Hot Goods provision “applies to holders of collateral obtained pursuant to a security agreement.” *Citicorp*, 483 U.S. at 29. Citicorp entered into a financing agreement with the predecessor-in-interest of Ely Group, Inc. (collectively, “Ely”) in which Citicorp agreed to lend to Ely the sum of \$11 million. To secure the loan, Ely granted to Citibank a lien in its inventory, accounts receivable, and other assets, and the lien was perfected under applicable state law. *Id.* Ultimately, Ely became insolvent and had to close its manufacturing facilities. Citicorp foreclosed on its liens, and took possession of its collateral, including inventory manufactured by Ely’s employees whose wages had not been paid in violation of the FLSA. *Id.* When Citicorp attempted to sell its collateral, an injunction was obtained by the Secretary of Labor. *Id.* at 30.

The Court noted that there are only two exceptions to the Hot Goods provision of the FLSA: (1) common carriers, and (2) ultimate purchasers without notice. *Id.* at 33-34. Otherwise, “all other persons, innocent or not, *are* subject to § 15(a)(1).” *Id.* at 34 (emphasis in original). Consequently, the Court affirmed the injunction issued by the lower courts prohibiting Citicorp from disposing of the collateral, noting that Citicorp “can cure the employer’s violation of the FLSA by paying the employees the statutorily required wages. . . “but that this “. . . does

not give the employees a ‘lien’ on the assets superior to that of a secured creditor.” *Citicorp*, 483 U.S. 38-39.

Perfection of the Lien:

As no lien is actually created under the Hot Goods provision, there are no requirements for perfection. However, as the Court stated in *Citicorp*, “secured creditors take their security interests subject to the laws of the land.” *Id.* at 39. So, an injunction may be issued by a court of competent jurisdiction against the possessor of such collateral upon proof that the collateral was manufactured in violation of the FLSA, and that there is no applicable exception. The injunction will remain in effect so long as the workers’ wages remain unpaid.

Priority of Lien:

Again, the Court in *Citicorp* noted that a “literal application of § 15(a)(1) does not grant employees a priority in ‘hot goods’ superior to that which a secured creditor has under state law.” *Citicorp*, 483 U.S. at 38. Rather, the secured creditor “still owns the goods, subject only to the ‘hot goods’ provision, which prevents it from placing them in interstate commerce.” *Id.*

Obligations Secured by the Lien:

Any injunction granted for a violation of the Hot Goods provision would terminate once the wages due in connection with the Hot Goods are paid to the employees.

Collateral Subject to Lien:

Any goods produced by a manufacturer who fails to comply with the minimum wage or overtime wage provisions of the FLSA. See 29 U.S.C. § 215(a)(1).

Classes of Secured Party/Debtor Subject to the Lien:

(a) The “secured party” would be the employees who have not yet received their wages in accordance with Sections 6 and 7 of the Act.

The “debtor” would be the secured party or other possessor of the “hot goods”, who must pay the unpaid wages before it can dispose of or otherwise use the collateral in interstate commerce.

How a Secured Party Can Maintain Its Priority or Protect Its Lien Against the Hidden Lien, Including Recommended Due Diligence:

As stated above, the Hot Goods provision includes two (2) exceptions: the first is for common carriers; and the second is for purchasers who acquire Hot Goods in good faith reliance on written assurance from the producer that the goods were produced in compliance with the requirements of the Act, and “who acquired such

goods for value without notice of any such violation . . .” 29 USC § 215(a)(1). In *Citicorp*, the petitioner (a secured creditor) did not argue that it was covered under either exception. *Id.* at 34. Rather, Citicorp argued that there should be an exception for innocent secured creditors, which the court rejected, in part, because there was “no duty to ascertain compliance with the FLSA.” *Id.* at 35. Consequently, when taking a security interest in goods, the secured party should, at a minimum, require written representations and warranties from the debtor that the goods are being manufactured in compliance with the FLSA.

The Court in *Citicorp* also focused on the reporting requirements involved in Citicorp’s loan to Ely, and noted that “[s]ecured creditors often monitor closely the operations of employer-borrowers. . . and may be in a position to insist on compliance with the FLSA’s minimum wage and overtime requirements.” *Citicorp*, 483 U.S. at 37. It follows that a secured creditor should include in its security agreements a covenant to comply with the FLSA.

Finally, since a secured party takes its collateral subject to the Hot Goods provision, which prevents it from placing them in interstate commerce until the workers’ wages are paid, a secured creditor should require indemnification from the debtor and all guarantors for any costs or expenses incurred in connection with lifting any injunction imposed pursuant to the Hot Goods provision of the FLSA, including, without limitation, the payment of any wages to employees involved in manufacturing goods constituting collateral for the secured party’s loan to the debtor.

Miscellaneous:

While the Court in *Citicorp* did not address the application of the Hot Goods provision in a bankruptcy context, the Sixth Circuit Court of Appeals addressed this issue in *Chao v. Hosp. Staffing Serv., Inc.*, 270 F.3d 374 (6th Cir. 2001). In *Chao*, the court rejected the holding of the Eleventh Circuit Court of Appeals in *Brock v. Rusco Indus.*, 842 F.2d 270 (11th Cir. 1988), which held that “a ‘hot goods’ action falls within the [11 USC] § 362 (b)(4) police power exception to the automatic stay.” *Chao*, 270 F.3d at 387 (citing *Brock*, 842 F.2d at 273). To determine whether this exception to the automatic stay applies in a particular Hot Goods action, the *Chao* Court applied two separate tests: a “pecuniary interest test”, and a “public policy” test. See *Chao*, 270 F.3d at 388-89, and 394. The pecuniary interest test focuses on “whether the enforcement action would result in a pecuniary *advantage* to the government vis-à-vis other creditors of the bankruptcy estate.” *Id.* at 389 (fn 9) (emphasis in original). The *Chao* court concluded that since the Secretary’s suit seeks only an injunction to prevent the bankruptcy trustee from introducing the goods in question into interstate commerce, there is no pecuniary gain to the government. Consequently, the *Chao* court found that the pecuniary interest test had been satisfied. *Id.* at 389.

The public policy test asks “whether a governmental unit brought suit ‘to enforce such governmental unit’s . . . police and regulatory power’” to vindicate private

rights or serve a public good. See *Chao*, 270 F.3d at 394. Because of the nature of the Hot Goods involved (records the bankruptcy trustee intended to use to create accounts receivable), the *Chao* court concluded that “the Secretary’s enforcement action does not protect other workers in the economy because the records at issue here will not --- unlike garments or windows and doors --- enter commerce and compete with fairly produced goods. . . the injunction action is merely a vehicle to enforce the private rights of the employees to minimum portion of their wages Congress guaranteed.” *Id.* at 393-394. The *Chao* court held that “the § 362 (b)(4) exception to the automatic stay does not apply to the instant action” and the Bankruptcy Court “had exclusive jurisdiction over the debtor and the property of its bankruptcy estate.” *Id.* at 394.

7. **Liens for utility and related services.**

- a. Lien for special assessment the weed and rubbish abatement under Government Code Section 39577.

[TO BE ADDED IN SUBSEQUENT DRAFT]

- b. Lien for abatement of nuisances under Government Code Section 38773.

[TO BE ADDED IN SUBSEQUENT DRAFT]

- c. Lien for furnishing utility services under Pub. Res. Code Section 5003.7.

How the Lien Arises/Attaches:

The lien under Cal. Pub. Res. Code Section 5003.7 for state utility services applies where the Department of Parks and Recreation or the Department of General Services is not paid for water, sewage, gas, electricity, garbage, or other utility services provided to real property owners. In order to effect the lien, a notice of lien must be recorded in the county where the real property is located.

Perfection of the Lien:

The lien encumbers real property and follows the general rule for real property liens in that it is perfected by recording a notice of lien in the county where the real property is located. California Public Resources Code § 5003.7(a).

Priority of the Lien:

The lien follows the general rule for real property liens in that takes priority from the date of recordation of the notice of lien. California Public Resources Code § 5003.7(e).

Civil Code § 2897 generally provides that, all other things being equal, different liens on the same property have priority according to the time of their creation. The statute creating this lien, California Public Resources Code § 5003.7, does

not provide for any different priorities and in fact expressly states that priority dates from the date of recordation of the lien.

The Obligations Secured by the Lien:

The lien created under California Public Resources Code § 5003.7 secures water, sewage, gas, electricity, garbage, or other utility services provided to real property owners by the Department of Parks and Recreation or the Department of General Services to real property. The lien extends to delinquent charges for 4 years prior to the filing of the notice of lien.

The Collateral Subject to the Lien:

The lien created under California Public Resources Code § 5003.7 applies to the real property to which the water, sewage, gas, electricity, garbage, or other utility services is provided.

The Classes of Secured Party/Debtor Subject to the Lien:

Debtors and secured parties with an interest in the real estate are subject to the lien arising under California Public Resources Code § 5003.7. The lien takes priority from the time of filing so it does not affect the priority of prior recorded liens.

How a Secured Party Can Maintain Its Priority or Protect its Lien Against the Lien, Including Recommended Due Diligence:

A secured party can protect itself against this lien by taking the usual actions it takes to protect itself against any other real estate lien that takes priority from the date of recordation: (a) performing a title search and obtaining title insurance for its deed of trust and (b) requiring its borrower to represent and warrant that there are no unpaid obligations owing with respect to the property that might result in a lien.

Miscellaneous:

The lien created under California Public Resources Code § 5003.7 does not appear to be cited in any published cases or referred to in any other California statutes.

- d. Special assessments for street and highway improvements under Sts. & Hwy. Code Section 3115.

[TO BE ADDED IN SUBSEQUENT DRAFT]

HIDDEN LIENS LIST

A. LIENS ARISING IN SALES TRANSACTIONS

1. **Interest of buyer in identified goods under Commercial Code Section 2501**
2. **Security interest reserved by seller pursuant to Commercial Code Section 2505.**
3. **Reclamation right of seller under Commercial Code Section 2702.**
4. **Security interest of buyer in rejected goods pursuant to Commercial Code 2711.**
5. **Lien of seller of real property under Civil Code Section 3046.**
6. **Lien of purchaser of real property under Civil Code Section 3050.**
7. Gift certificate as trust property under Civil Code Section 1749.6.

B. LIENS FOR PERFORMANCE OF SERVICES

1. Bankers' liens
 - a. **Banker's lien under Civil Code Section 3054**
 - b. **Banker's lien under Fin. Code 1670.**
 - c. Security interest of collecting bank in items, accompanying documents and proceeds under Commercial Code Section 4210.
 - d. Lien of presenting bank under Commercial Code Section 4504.
 - e. Security interest in document presented under letter of credit pursuant to Commercial Code Section 5118.
 - f. Depositary lien under Civil Code Section 1856.
2. Liens for Warehousing and Storage
 - a. **Warehouseman's lien under Commercial Code Section 7209.**
 - b. **Garageman's lien under Civil Code Section 3068.**
 - c. Lien for self-service storage facility under Bus. & Prof. Code Section ____
 - d. Safekeeping of funds or property of inmate after death, escape discharge or parole under Government Code Section 6602.

- e. Towing or storage lien under Civil Code Section 3068.1.
 - f. Lien of frozen food locker plant under Health & Safety Code Sections 28718 and 112590.
3. Carriers' Liens
- a. Carrier's lien under Commercial Code Section 7307.**
 - b. Carrier's lien for freightage under Civil Code Section 2144.**
 - c. Common carrier's lien on luggage under Civil Code Section 2191.
4. Other Liens for Services
- a. Lien for services under Civil Code Sections 3051 and 3051.5.6.**
 - b. Limitation on lien of electronic and appliance repair dealers under Bus. & Prof. Code Section 9852.
 - c. Hotelkeeper's lien under Civil Code Section 1861.
 - d. Apartment keeper's lien under Civil Code Section 1861a.
 - e. Lien for provision of health services under Civil Code Section 3040.
 - f. Hospital lien for emergency and ongoing services under Civil Code Section 3045.1
 - g. Jeweler's lien under Civil Code Section 3052a.**
 - h. Lien of mining claimant under Civil Code Section 3060.**
 - i. Thresherman's lien under Civil Code Section 3061.
 - j. Logger's and lumberman's lien under Civil Code Section 3065.**
 - k. Cleaner's and launderer's lien under Civil Code Section 3066.
 - l. Mechanic's lien under Civil Code Sections 3110-3112.
 - m. Factor's lien under Civil Code Section 3053.**
 - n. Lien for aircraft repairs under Bus. & Prof. Code Section 9798.1.**
 - o. Design professional's lien under Civil Code Section 3081.4.
 - p. Lien for repairs and storage of personal property for the operation of airports under Pub. Util. Code Section 21640.**

q. Customs broker's lien under 19 U.S.C. §1564.

r. Labor claims including preferred labor claims in assignments for the benefit of creditors under Code of Civil Procedure Section 1204, preferred labor claims in bulk sales under Code of Civil Procedure Section 1205, preferred labor claims after levy under writ of attachment or execution under Code of Civil Procedure Section 1206, employee's lien on proceeds paid to employer from workmen's compensation policy under Ins. Code Section 11656, lien for providing worker's compensation policy upon finding that employer is illegally uninsured under Lab. Code Section 3720, lien for unpaid penalty assessment for failure to provide worker's compensation insurance under Lab. Code Section 3727.

C. LIENS ARISING IN LITIGATION

- 1. Attachment of farm products or inventory of going business by taking possession through a "keeper" under Code of Civil Procedure Section 488.395.**
- 2. Judgment and Execution Orders under Code of Civil Procedure Sections 708.110, 708.120 and 708.205.**
- 3. Liens arising in creditor's suit under Code of Civil Procedure Section 708.250.**
- 4. Liens arising under charging order under Code of Civil Procedure Section 708.320 and Corporations Code Sections 16504 and 17302.**
- 5. Liens for money owed to judgment debtor by public entity under Civil Procedure Section 708.780.**
6. Liens in pending actions or proceedings under Code of Civil Procedure Section 491.410.
7. Execution liens under Code of Civil Procedure Section 697.710.

D. AGRICULTURAL LIENS.

- 1. Trust under Perishable Agricultural Commodities Act, 7 U.S.C. §§499 *et seq.* Report Section P**
- 2. Trust under Packers and Stockyards Act, 7 U.S.C. §§181 *et seq.***
3. Lien for pest abatement under Food & Agric. Code Section 5431.
4. Lien on land for removal of plants and crops which are nuisances under Food & Agric. Code Section 5632.
5. Lien for camelthorn abatement under Food & Agric. Code Section 7305.
6. Lien for expenses of treating cattle or sheep under Food & Agric. Code Section 9331.

7. Lien for expenses for confinement of cattle under Food & Agric. Code Section 10152.
8. Lien for expenses of vaccinating calves under Food & Agric. Code Section 10355.
9. Lien for expenses of testing cattle in brucellosis control area under Food & Agric. Code Section 10385.
10. Lien for caring of animals under Food & Agric. Code Section 16526.
11. Lien of railroad for expenses associated with transportation of animals, Food & Agric. Code Section 16907.
12. Lien for care of stray animals under Food & Agric. Code Section 17041.
13. Agricultural producer's lien under Food & Agric. Code Section 55631.
14. Livestock seller's lien under Food & Agric. Code Section 55702.
15. Dairy cattle supply lien under Food & Agric. Code Section 57402.
16. Poultry and fish supply lien under Food & Agric. Code Section 57510.
17. Agricultural chemical and seed lien under Food & Agric. Code Section 57561.
- 18. Agricultural laborer's lien under Civil Code Section 3061.5.**
19. Lien for service of stallion, jack or bull under Civil Code Section 3062.
20. Livestock servicer's lien under Civil Code Section 3080.01.
21. Lien on crops of a disabled veteran for operation of farm by Department of Veterans' Affairs under Mil. & Vet. Code Section 987.9.

E. TAX AND OTHER GOVERNMENTAL LIENS

- 1. Federal tax liens arising under the Internal Revenue Code against "all property and rights to property, whether real or personal" that belong to the taxpayer, 26 U.S.C. §6321.**
- 2. Unpaid sales and use taxes under Rev. & Tax. Code Section 6757.**
3. Unpaid unemployment compensation taxes under Unemp. Ins. Code Section 1703.
4. Tax liens generally. See Government Code section 7171 (state tax lien); Rev. & Tax Code Section 2191.3-.6 (county tax liens); Pub. Res. Code Section 4178 (fire hazard abatement); Rev. & Tax. Code Section 11491-11496 (taxes on private railroad cars). (bold-face only)

5. **Environmental contamination giving rise to liens under the Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. §§9601 *et seq.* (CERCLA).**
6. **ERISA liens under 29 U.S.C. §1368.**
7. **Lien for public employees' retirement systems under Government Code Section 20574.**
8. **Liens for unpaid wages pursuant to the "hot goods" section of the federal Fair Labor Standards Act, 29 U.S.C. §215(a)(1).**
9. Claims arising under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§1961 *et seq.* (RICO) (relating back to date of violation).
10. Liens for utility and related services.
 - a. **Lien for special assessment the weed and rubbish abatement under Government Code Section 39577.**
 - b. Liens for fees for waste disposal services under Government Code Section 2583 1(d).
 - c. Liens for removal of dirt, rubbish, weeds, etc. under Government Code Section 39501.
 - d. Lien for removal of obstructions or noxious materials under Government Code Section 39502.
 - e. **Lien for abatement of nuisances under Government Code Section 38773.**
 - f. **Lien for furnishing utility services under Pub. Res. Code Section 5003.7.**
 - g. Lien for charges for light, water and other utilities under Pub. Util. Code Section 16470.
 - h. Lien for corrective actions with respect to timber harvesting under Pub. Res. Code Section 4608.
 - i. Lien for abatement of nuisance by pest abatement districts under Health & Safety Code Section 2864.
 - j. Lien for unpaid hazardous waste abatement under Health & Safety Code Section 14912.
 - k. Unpaid charges for services rendered upon leased sanitation facilities under Health & Safety Code Section 5061.

- l. Lien for connection of dwelling to sewer under Health & Safety Code Sections 5463 and 5464.
 - m. Liens for fees for waste disposal services under Government Code Section 1191-1192.
 - n. Lien for mosquito abatement under Health & Safety Code Section 2284.
 - o. Lien for abatement of controlled substances under Health & Safety Code Section 42406.
 - p. Lien for radiation contamination under Health & Safety Code Section 115205.
 - q. Lien for rodent abatement under Health & Safety Code Section 116155.
 - r. Lien for forest fire hazards under Pub. Res. Code Section 4477.
 - s. Charges assessed by water districts under Water Code Section 46280.
 - t. Delinquent water service standby and availability charges under Water Code Section 155501.1.
 - u. Lien for fine for contempt when building used for prostitution in violation of abatement order under Penal Code Section 11233.
 - v. Liens for taxes levied by municipal utility district under Pub. Util. Code Section 12904.
11. Health Facility Related Liens
- a. Lien for local hospital district taxes under Health & Safety Code Section 32204.
 - b. Lien for health facility receiver expenses under Health & Safety Code
12. Other Liens
- a. Lien for penalties for polluting vessels under Health & Safety Code Section 42406.
 - b. Lien for plaintiff's costs in abatement action to enjoin operation of gambling ship under Penal Code Section 11310.
 - c. Lien for navigation penalties under Harb. & Nav. Code Section 266.
 - d. Salvage lien under Harb. & Nav. Code Section 534.
 - e. Lien for penalties for polluting vessel under Health & Safety Code Section
 - f. Lien for oil and gas conservation under Pub. Res. Code Sections 3226 and 3680.

- g. Vehicle license fee under Rev. & Tax. Code Section 10876.
- h. Liens for taxes levied by the Bay Area Air Quality Management District under Health & Safety Code Section 40273.
- i. Lien for taxes and charges on gas production under Pub. Res. Code Section 3423.
- j. Taxes levied by airport districts under Pub. Util. Code Section 22908.
- k. Taxes levied by San Francisco Bay Area Transit District under Pub. Util. Code Section 29131.
- l. Taxes levied by the Santa Cruz Metropolitan Transit District under Pub. Util. Code Section 98289.3.
- m. Unpaid tax for vehicle fuel license taxes under Rev. & Tax. Code Section 6757.
- n. Use fuel excise tax under Rev. & Tax. Code Sections 8991-8997.
- o. Taxes on insurers under Rev. & Tax. Code Sections 12491-12495.
- p. Unpaid cigarette taxes under Rev. & Tax. Code Section 30322.
- q. Unpaid alcoholic beverage tax under Rev. & Tax. Code Section 32363.
- r. Unpaid timber yield taxes under Rev. & Tax. Code Section 38523.
- s. Special assessments for street and highway improvements under Sts. & High. Code Section 3115.**
- t. Street improvements under 1911 Street Improvement Act under Sts. & High. Code Section 5373.
- u. Special assessments for sidewalks and curb improvements under Sts. & High. Code Section 5890.
- v. Special assessments for city street lighting under Sts. & High. Code Section 18403.
- w. Taxes levied by highway lighting districts under Sts. & High. Code Section 19184.
- x. Special assessment for tree planting under Sts. & High. Code Section
- y. Taxes for benefit of bridge and highway districts under Sts. & High. Code Section 27205.
- z. Lien for vehicle fees, taxes and penalties under Veh. Code Section 9800.

- AA. Storage of vehicle which has been towed under Veh. Code Section 22851.
 - BB. Unpaid toll fees under Veh. Code Section 23303.
 - CC. Lien for payments due under Medi-Cal Program under Welf. & Inst. Code Section 14124.74-.75.
 - DD. Lien the overpayment by state to healthcare providers under Welt. & Inst. Code Section 14173.
 - EE Unpaid gift taxes under Rev. & Tax. Code Section 16063.
 - FF. Unpaid personal income taxes under Rev. & Tax. Code Section 18881.
 - GG. Hazardous substances taxes under Rev. & Tax. Code Section 43413.
 - HH. Highway use taxes under Veh. Code Section 8162.
 - II. Unpaid water charges under Water Code Section 36729.
 - JJ. Liens of federal government obtained by title vesting. See *Manne Midland Bank v. United States*, 687 F. 2d 395,397,404 (Ct. Cl. 1982), cert. den. 460 U.S. 1037 (1982).
6. LIENS ON PARTICULAR TYPES OF PERSONAL PROPERTY COLLATERAL
- A. Maritime liens under Title 46 of the United States Code.
 - B. Issuer's lien under Commercial Code Section 8209.
 - C. Oil and gas liens under Code of Civil Procedure Section 1203.52-.66.
 - D. Aircraft lien law under Code of Civil Procedure Section 1208.
 - E. Credit union's lien on member's shares under Fin. Code Section 14856.
 - F. Lien of conservator of escrow' agent under Fin. Code Section 17631.
 - G. Lien on tax receipts for money borrowed by county, city, municipal corporation, etc. under Government Code Section 53829.
 - H. Bottomry under Harb. & Nav. Code Sections 450-462.
 - I. Actions against vessels under Harb. & Nav. Code Sections 490-495.
 - J. Service lien on vessels under Harb. & Nav. Code Section 501.
 - K. Lien for expenses of heirs with undivided interests in property under Prob. Code Section 11955.

- L. Lien for unpaid charges and penalties in connection with geothermal resources drilling under Pub. Res. Code Section 3772.
 - M. Liens on motor vehicles under Veh. Code Section 9919.
 - N. Liens on U.S. flag vessels, aircraft, railroad cars, locomotives, rolling stock, patents, trademarks, copyrights, maskworks, plant patents and other property with respect to which all or a portion of state law is preempted by federal law.
 - O. Rescinding partner's lien on surplus under Corp. Code Section 15039.
 - P. Lien of partners on mining partnership under Pub. Res. Code Section 3943.
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